DOCKET

EDITOR'S NOTE

THE FOLLOWING PAGES WERE POOR HARD COPY AT THE TIME OF FILMING. IF AND WHEN A BETTER COPY CAN BE OBTAINED, A NEW FICHE WILL BE ISSUED.

No. 86-1602-CFX
Status: GRANTED

Title: United Savings Association of Texas, Petitioner
v.
Timbers of Inwood Forest Associates, Inc.

Docketed:
April 3, 1987

Court: United States Court of Appeals
for the Fifth Circuit

Counsel for petitioner: Cohn,H. Miles

Counsel for respondent: Henderson,Timothy J.

Entry	Date	Note	Proceedings and Orders
1	Apr 3 1987	G	Petition for writ of certiorari filed.
2	May 6 1987		Brief of respondent Timbers of Inwood Forest Associates in opposition filed.
3	May 6 1987		DISTRIBUTED. May 21, 1987
5	May 26 1987		Petition GRANTED. ***
6	Jun 3 1987		Record filed.
8	Jun 26 1987		Order extending time to file brief of petitioner on the merits until August 3, 1987.
9	Jul 9 1987		Joint appendix filed.
10	Jul 28 1987		Brief amicus curiae of Thomas H. Jackson filed.
12	Aug 1 1987		Brief of petitioner United Savings Assn. of TX filed.
11	Aug 3 1987		Brief amici curiae of California League of Savings Institutions, et al. filed.
13	Aug 3 1987		Brief amicus curiae of United States filed.
16	Aug 3 1987		Brief amicus curiae of National Commercial Finance Assn. filed.
15	Aug 4 1987		Order extending time to file brief of respondent on the merits until October 1, 1987.
21	Aug 31 1987		Brief amici curiae of Raymond T. Nimmer, et al. filed.
17	Sep 30 1987		Brief amicus curiae of Natl. Assn. of Credit Management filed.
18	Oct 1 1987		Brief of respondent Timbers of Inwood etc. filed.
19	Oct 1 1987		Brief amicus curiae of Global Marine Inc. filed.
20	Oct 5 1987	D	Motion of Global Marine, Inc. for leave to participate in oral argument as amicus curiae, for divided argument and for additional time for oral argument filed.
22	Oct 9 1987		CIRCULATED.
23	Oct 9 1987		SET FOR ARGUMENT. Tuesday, December 1, 1987. (4th case).
24	Oct 19 1987		Motion of Global Marine, Inc. for leave to participate in oral argument as amicus curiae, for divided argument and for additional time for oral argument DENIED.
25	Nov 19 1987	X	Reply brief of petitioner United Savings Assn. of TX filed.
26	Dec 1 1987		ARGUED.

PETITION FOR WRIT OF CERTIORARI

86 1602 ①

Supreme Court, U.S.
FILED
APR 3 1987
JOSEPH F. SPANIOL, JR.
CLERK

NO. ____________

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

H. MILES COHN
SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700

Counsel for Petitioner

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

198 pp

QUESTION PRESENTED

Bankruptcy Code section 362(d)(1) requires "adequate protection" of a secured creditor's "interest in property" as a condition to the automatic stay, which from the filing of a bankruptcy case stays the creditor from exercising its rights under state law to foreclose on and sell its collateral and reinvest the proceeds. Does this requirement for "adequate protection," which is defined in Bankruptcy Code section 361, include protection for the costs of the delay in enforcing rights under state law (the "lost time value" or "lost opportunity costs") imposed by the automatic stay?

LIST OF PARTIES

The parties to the proceedings below were the Petitioner, United Savings Association of Texas, and the Respondent, Timbers of Inwood Forest Associates, Ltd.

United Savings Association of Texas is a savings and loan association organized under the laws of the State of Texas. Dime Savings Bank of New York, a banking corporation organized under the laws of the State of New York, is a participating lender in the loan made by United Savings Association of Texas to Timbers of Inwood Forest Associates, Ltd., and is therefore a part owner of the promissory note and liens at issue.

Timbers of Inwood Forest Associates, Ltd. is a limited partnership organized under the laws of the State of Texas. The general partners of the partnership are Woody Mann, Jr. and Dorado Corporation; the limited partners of the partnership are W. B. Easter, Arthur C. Morales and Arden D. Christianson.

TABLE OF CONTENTS

Page

QUESTION PRESENTED I

LIST OF PARTIES II

TABLE OF AUTHORITIES IV

OPINIONS BELOW 1

JURISDICTION 2

STATUTES INVOLVED 3

STATEMENT OF THE CASE 4

REASONS FOR GRANTING THE WRIT 10

I. THE DECISION OF THE FIFTH CIRCUIT COURT OF APPEALS DIRECTLY CONFLICTS WITH RECENT DECISIONS OF THREE OTHER COURTS OF APPEALS ON AN ISSUE OF PROFOUND IMPORTANCE TO BANKRUPTCY LAW. 11

II. THE DECISION OF THE COURT OF APPEALS LEAVES UNPROTECTED THE VALUE OF RIGHTS UNDER STATE LAW IN PROPERTY OF THE BANKRUPTCY ESTATE, IN DISREGARD OF CONGRESS' MANDATE OF "ADEQUATE PROTECTION" AND CONTRARY TO PRIOR DECISIONS OF THIS COURT. 17

CONCLUSION 24

CERTIFICATE OF SERVICE 25

APPENDIX A—En Banc Opinion of Fifth Circuit, dated January 9, 1987 .... 1a

APPENDIX B—Opinion of Fifth Circuit, dated July 9, 1986 .... 53a

APPENDIX C—Opinion of Fifth Circuit Ordering Case to be Reheard En Banc, dated July 9, 1986 134a

APPENDIX D—Memorandum and Order of District Court, dated September 23, 1985 .... 136a

APPENDIX E—Order Granting Relief from Stay of District Court, dated October 11, 1985 ..... 139a

APPENDIX F—Opinion of Bankruptcy Court, dated May 7, 1985 .... 142a

APPENDIX G—Order of Bankruptcy Court, dated April 19, 1985 .... 157a

APPENDIX H—Circuit-By-Circuit Summary of Cases Decided Under Bankruptcy Code Re Time Value Compensation 159a

TABLE OF AUTHORITIES

CONSTITUTION

Page
U.S. Const., art. 1, § 8, cl. 4 .... 13, 19

CASES

Page
Butner v. United States, 440 U.S. 48, 59 L.Ed.2d 136, 99 S. Ct. 914 (1979) 13, 14, 17, 19
Lewis v. Manufacturers National Bank, 364 U.S. 603, 5 L.Ed.2d 323, 81 S. Ct. 347 (1961) 14
Reading Co. v. Brown, 391 U.S. 471, 20 L.Ed.2d 751, 88 S. Ct. 1759 (1968) 23
Sexton v. Dreyfus, 219 U.S. 339, 55 L.Ed. 244, 31 S. Ct. 256 (1911) 18
Stellwagen v. Clum, 245 U.S. 605, 62 L.Ed. 507, 38 S. Ct. 215 (1918) 13
United States v. Kimbell Foods, Inc., 440 U.S. 715, 59 L.Ed.2d 711, 99 S. Ct. 1448 (1979) 16
United States v. Whiting Pools, Inc., 462 U.S. 198, 76 L.Ed. 2d 515, 103 S. Ct. 2302 (1983) 20, 21, 22
Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 91 L.Ed. 163, 67 S. Ct. 237 (1946) 13
In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) 5, 8, 11, 14, 15
In re Briggs Transportation Company, 780 F.2d 1339 (8th Cir. 1985) 5, 11
In re Grundy National Bank v. Tandem Mining Corp., 754 F.2d 1436 (4th Cir. 1985) 5, 11
In re Timbers of Inwood Forest Associates, Ltd., 808 F.2d 363 (5th Cir. 1987) (*en banc* opinion) 1, 12, 15, 18, 24
In re Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380 (5th Cir. 1986) (panel opinion) ... 2, 9, 11, 12, 14, 15, 23, 24
In re Timbers of Inwood Forest Associates, Ltd., 49 B.R. 454 (Bkrpcy. S.D. Tex. 1985) 2, 6, 7, 8, 23

UNITED STATES STATUTES

Page
11 U.S.C. § 361 3
11 U.S.C. § 362(a) 4
11 U.S.C. § 362(d) 4, 19
11 U.S.C. § 362(d)(1) 3, 5, 6
11 U.S.C. § 363 8
11 U.S.C. § 363(e) 21
11 U.S.C. § 365(d)(3) 22
11 U.S.C. § 503(b) 22
11 U.S.C. § 507(a)(1) 22
11 U.S.C. § 542 20
11 U.S.C. § 725 22
11 U.S.C. § 726 22
11 U.S.C. § 1129(b)(2)(A) 23
28 U.S.C. § 157(a) 6
28 U.S.C. § 158(a) 8, 9
28 U.S.C. § 158(b) 9
28 U.S.C. § 158(d) 9
28 U.S.C. § 1254(1) 2
28 U.S.C. § 1334(a) 6

HOUSE & SENATE REPORTS

H. REP. NO. 595, 95th Cong., 1st Sess. (1977) 18
S. REP. NO. 989, 95th Cong., 2d Sess. (1978) 19

ARTICLES

Baird and Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy,* 51 U. CH. L. REV. 97 (1984) 18
Jackson, *Of Liquidation, Continuation and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules,* 60 AM. BK. L.J. 399 (1986) 23
Jackson & Kronman, *Secured Financing and Priorities Among Creditors,* 88 YALE L.J. 1143, 1147-49, 1163 (1979) 16
Norton, 1984 ANNUAL SURVEY OF BANKRUPTCY LAW 197 14
Note, *Recent Developments—Relief from the Automatic Stay: Section 362(d),* 3 BKR. DEV. J. 199 (1986) ... 14
"Real Estate Decline Spurs S & L Crisis," HOUSTON POST, March 29, 1987, at E1 15
"Texans are Holding Sway on Bank, S & L Regulation," WALL ST. J., Feb. 11, 1987, at 6, col. 1 15

NO. ____________

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

To The Honorable, The Chief Justice And Associate Justices Of The Supreme Court of The United States:

United Savings Association of Texas, the Petitioner herein, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in the above-entitled case on January 9, 1987.

OPINIONS BELOW

The January 9, 1987, opinion of the Court of Appeals for the Fifth Circuit is reported at 808 F.2d 363. This opinion of the court of appeals, sitting *en banc*, is reprinted as Appendix A to this Petition, at 1a.

The *en banc* opinion reinstates the prior opinion of a panel of the court of appeals, dated July 9, 1986, which is reported at 793 F.2d 1380. The panel opinion is reprinted as Appendix B, at 53a. The opinion of the court of appeals ordering the case to be reheard *en banc*, also dated July 9, 1986, is printed as Appendix C, at 134a.

The Memorandum and Order of the District Court for the Southern District of Texas, from which an appeal was taken by the Respondent to the court of appeals, is not published. The Memorandum and Order, dated September 23, 1985, is printed as Appendix D, at 136a. The district court also entered an Order Granting Relief from Stay; this unpublished Order, dated October 11, 1985, is printed as Appendix E, at 139a.

The opinion of the Bankruptcy Court for the Southern District of Texas, from which an appeal was taken by the Respondent to the district court, is published at 49 B.R. 454. The opinion, dated May 7, 1985, is reprinted as Appendix F, at 142a. The bankruptcy court's Order, which required the adequate protection payments at issue in this case, is unpublished. The Order, dated April 19, 1985, is printed as Appendix G, at 157a.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit, sitting *en banc*, was entered on January 9, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves a motion for relief from the automatic stay of an act against property, filed pursuant to Bankruptcy Code section 362(d)(1), 11 U.S.C. § 362 (d)(1). This statute provides:

> *11 U.S.C. § 362(d)(1)*
>
> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest. . . .

Examples of "adequate protection" are listed in Bankruptcy Code section 361, 11 U.S.C. § 361, which provides:

> *11 U.S.C. § 361*
>
> When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use,

> sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

STATEMENT OF THE CASE

This case involves a factual pattern that recurs thousands of times each year in bankruptcy cases throughout the United States: a secured creditor whose collateral is worth less than the amount of its debt is prevented from foreclosing its security interest under applicable state law by the automatic stay of Bankruptcy Code section 362(a), 11 U.S.C. § 362(a), which takes effect when a bankruptcy petition is filed. Under state law, following an event of default and in the absence of bankruptcy, the creditor would be permitted to foreclose its security interest, sell the collateral, and reinvest (or relend) the proceeds at a market rate of return. As a result of the automatic stay, however, the creditor is prevented for a period of time from exercising its rights to reinvest the collateral proceeds, and is thereby deprived of income that could have been earned but for the automatic stay. Under these circumstances, the undersecured creditor's only effective remedy is to bring a motion for relief from the automatic stay pursuant to Bankruptcy Code section 362(d), 11 U.S.C. § 362(d), seeking either to have the stay lifted to permit foreclosure or other disposition of the collateral, or to have the stay conditioned upon the providing of "adequate protection" for the value of the creditor's interest in the property. 11 U.S.C. §§ 362(d)(1), 361.

Within a period of approximately two years, four separate courts of appeals have developed three mutually inconsistent rules of law as to whether "adequate protection" requires that an undersecured creditor be compensated for the delay in enforcing its rights under state law to foreclose on and sell its collateral and reinvest the proceeds. The interpretation of "adequate protection" adopted by the Ninth and Fourth Circuits requires, as a matter of law, the protection of the time value of an undersecured creditor's rights under state law. *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984). *Accord, Grundy National Bank v. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985). The Eighth Circuit, in an opinion purporting to be "entirely consistent" with *American Mariner* and *Grundy*, has ruled that while the time value of a secured creditor's rights may be entitled to protection, whether such protection should be provided is a determination to be made by the bankruptcy court on a "case-by-case" basis. *In re Briggs Transportation Company*, 780 F.2d 1339 (8th Cir. 1985).

In the present case, a sharply divided Fifth Circuit, sitting *en banc*, has become the first court of appeals to hold that, as a matter of law, a secured creditor is not entitled to protection for the costs of delay created by the automatic stay in enforcing state law foreclosure rights. In so holding, the Fifth Circuit explicitly rejected both the position of the Ninth and Fourth Circuits and the separate position of the Eighth Circuit.

The Petitioner, United Savings Association of Texas ("United Savings"), is the holder of a promissory note executed by the Respondent, Timbers of Inwood Forest Associates, Ltd. ("Timbers"), in the original principal amount of $4,100,000; the note is secured by a first lien deed of trust covering Timbers of Inwood Forest Apartments, Phase I, an apartment project located in Houston, Texas. Following Timbers' default under the note, United Savings posted the property for foreclosure sale, under the deed of trust, for March 5, 1985. Timbers filed its petition under Chapter 11 of the Bankruptcy Code on March 4, the day before the posted foreclosure; pursuant to Bankruptcy Code section 362(a), United Savings was automatically stayed from holding the foreclosure sale or otherwise enforcing its rights under the deed of trust.

On March 18, 1985, United Savings filed a motion for relief from the automatic stay, pursuant to Bankruptcy Code section 362(d)(1). The bankruptcy court had jurisdiction to hear this motion pursuant to 28 U.S.C. § 1334(a) and 28 U.S.C. § 157(a). An evidentiary hearing was held on April 17, but the facts were largely undisputed. As the bankruptcy court found, 49 B.R. at 459, 460-61, Timbers' obligation to United Savings was in serious default. Accrued unpaid interest exceeded $430,000 at the time of the hearing, and was continuing to rise at a rapid rate. Because the principal balance of the note exceeded $3,900,000, the total debt exceeded $4,360,000 at the hearing.

At the time of the hearing in bankruptcy court, it was undisputed that the note had been in default for over one year, with no attempt having been made to pay accruing interest or other sums. It was also undisputed that this continually-accruing interest could not be secured by any similar increase in the value of the property. While expert appraisers testifying at the hearing both stated that the value of the property would appreciate in the future, neither foresaw any rapid or significant appreciation in the near future. The bankruptcy court concluded that "the value of the collateral is stable, *perhaps* slightly (but *very* slightly) appreciating." 49 B.R. at 456. Because the court also found that the market value of the property was less than the debt secured thereby, 49 B.R. at 460, there was nothing to secure the payment of rapidly-accruing interest under the note.

Under the deed of trust and applicable state law, United Savings is entitled to have the property securing its debt sold at foreclosure sale, to recover the proceeds of such sale and to reinvest those proceeds. The automatic stay of Bankruptcy Code section 362(a) prevented United Savings from exercising its rights under state law, and thereby deprived it of the income that could have been earned on the reinvested proceeds. The bankruptcy court found that had United Savings been allowed to foreclose and reinvest the collateral proceeds, it could have reinvested the sum of $4,250,000, earning interest at the rate of 12% per annum beginning six months after the foreclosure; but for the automatic stay, therefore, United Savings could have earned $42,500 per month beginning in September, 1985. 49 B.R. at 460-61. This lost income is the "time value" of United Savings' right under the deed of trust to foreclose *upon default;* it is the same interest that some have labeled "the lost opportunity costs" imposed by the automatic stay.

Following the Ninth Circuit's decision in *American Mariner*, the bankruptcy court held that United Savings' right under state law to foreclose upon default has " 'substantial, measurable value,' " 49 B.R. at 456-57, *quoting American Mariner*, 734 F.2d at 435, and that this right is entitled to adequate protection. In order to protect this valuable right, the bankruptcy court conditioned the automatic stay on the monthly payment of a sum equal to the income lost to United Savings as a result of the stay. The bankruptcy court ordered Timbers to commence monthly payments, beginning six months after the filing of the bankruptcy case, in the amount of $42,500; the court allowed Timbers to use rents of the property (United Savings' cash collateral under Bankruptcy Code section 363) to make these payments, but held that the automatic stay would terminate if the payments were not made.

Following the entry of the bankruptcy court's Order on United Savings' motion for relief from stay, Timbers perfected an appeal to the United States District Court for the Southern District of Texas. The jurisdiction of the district court to hear the appeal is provided by 28 U.S.C. § 158(a); that statute provides, in relevant part, that "the district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees . . . of bankruptcy judges entered in cases and proceedings. . . ." On September 23, 1985, the district court entered its Memorandum and Order affirming the Order of the bankruptcy court. Because Timbers had defaulted under the bankruptcy court's Order, by not making the adequate protection payments required to begin in September, 1985, the district court also entered an Order, dated October 11, 1985, terminating the automatic stay.

Following the district court's orders affirming the bankruptcy court and terminating the automatic stay, Timbers perfected an appeal to the United States Court of Appeals for the Fifth Circuit. The jurisdiction of the court of appeals is provided by 28 U.S.C. § 158(d), which provides that the court of appeals "shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under [28 U.S.C. § 158(a) and (b)]." The appeal was originally heard by a three-judge panel. The panel opinion of the court of appeals, issued on July 9, 1986, reversed the orders of the bankruptcy and district courts insofar as they required monthly payments, and remanded for further proceedings; the court concluded, contrary to the bankruptcy and district courts and contrary to prior decisions of the Ninth, Fourth and Eighth Circuits, that United Savings was not entitled to "periodic post-petition interest payments . . . to compensate it for the delay of the reorganization proceeding during the pendency of the automatic stay." 793 F.2d at 1416. In the panel's view, Congress intended that a secured creditor be adequately protected only for the fixed amount of its "allowed secured claim," an amount that is strictly limited to the value of the physical property securing the debt. *Id.* at 1385-87, 1399-1400, 1413, 1416.

On the same day the panel opinion was issued, the court of appeals vacated the panel opinion and set the case for rehearing *en banc*. The sharply divided opinion of the *en banc* court, issued on January 9, 1987, after supplemental briefing and a six-month delay, reinstated the opinion and order of the panel. Because the court of appeals had stayed the orders of the lower courts terminating the automatic stay, United Savings was stayed from foreclosing under the deed of trust throughout the time this case was pending before the court of appeals.

REASONS FOR GRANTING THE WRIT

In holding that, as a matter of law, "adequate protection" does not require protection of the "time value" of a secured creditor's state law rights to foreclose on and sell its collateral and reinvest the proceeds, the decision of the court below admittedly conflicts with prior decisions of the Ninth, Fourth and Eighth Circuits and of numerous lower courts as well. Whether such protection is required or permitted by the Bankruptcy Code is perhaps the most important and frequently litigated issue in the entire field of bankruptcy law, and the resolution of this issue ought not to depend upon the fortuity of the jurisdiction in which a bankruptcy case is filed. Prompt resolution of this issue and the establishment of a uniform federal standard is required. The decision of the Fifth Circuit misconstrues congressional intent, ignores prior decisions of this Court, drastically alters the allocation of risk and bargaining leverage in reorganization proceedings, threatens to affect the availability and affordability of asset-based financing in jurisdictions in which it is followed, and creates powerful "forum-shopping" incentives for debtors seeking to obtain involuntary, costless financing from their secured creditors.

I.

THE DECISION OF THE FIFTH CIRCUIT COURT OF APPEALS DIRECTLY CONFLICTS WITH RECENT DECISIONS OF THREE OTHER COURTS OF APPEALS ON AN ISSUE OF PROFOUND IMPORTANCE TO BANKRUPTCY LAW.

The court below openly acknowledges that its refusal to protect the "time value" of a secured creditor's state law property rights, without regard to the facts of the case, conflicts with recent decisions of three other courts of appeals and with numerous lower courts throughout the country. The Courts of Appeals for the Ninth and Fourth Circuits have required protection of time value as a matter of law. *See In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984); *Grundy National Bank v. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985). The Court of Appeals for the Eighth Circuit agrees with the Ninth and Fourth Circuits that the time value of a secured creditor's rights may be entitled to protection, but holds that whether such protection should be provided is a factual matter for determination by the bankruptcy judge based on the circumstances of the case. *See In re Briggs Transportation Company*, 780 F.2d 1339 (8th Cir. 1985). The court below vigorously criticizes these conflicting decisions of the Ninth, Fourth and Eighth Circuit Courts of Appeals. 793 F.2d at 1411-16.

As the panel opinion recognizes, 793 F.2d at 1411 & n.53 (and cases cited), 1412 & n.57 (and cases cited), the issue raised in this case has been vigorously litigated in many lower courts as well. A review of the lower court cases addressing this issue reveals that the conflict in authorities now extends to bankruptcy and district courts in every circuit.[1] Besides the three-way intercircuit conflict among the Ninth, Fourth, Eighth and Fifth Circuits, *intra*circuit conflicts on the same issue have arisen in district and bankruptcy courts in at least seven of the remaining eight circuits.[2] Bankruptcy commentators are also divided on this issue.[3]

As the dissent in the court below recognizes, the consequences of the court's decision "are profound." 808 F.2d at 375 (Jones, J., dissenting). Perhaps the most immediate effect of the court's opinion will be an undeniable "rush of forum shopping by debtors into the already beleaguered bankruptcy courts of the Fifth Circuit" and other jurisdictions following the same rule. *Id.* If a debtor can avoid the requirement that it protect the value of secured creditors' rights in property merely by filing his case in the Fifth Circuit, surely numerous debtors will do so. This incentive for forum shopping is illustrated by the facts of this case. Had Timbers filed this case in a bankruptcy court in the Ninth Circuit, the automatic stay would already have been terminated because of its failure to compensate United Savings for the costs of delay imposed by the automatic stay. Under the rule adopted by the Fifth Circuit, by contrast, the bankruptcy court cannot require any protection for the costs of delay imposed by the automatic stay, no matter for how long the case might proceed.

The ability of the secured creditor to insist on periodic payments or other compensation ordinarily will depend on the terms of the security agreement and on the applicable state law, for secured creditors with different agreements and in different states have differing substantive and procedural rights to foreclose their security interests. But while the terms of the security agreement and the choice of applicable state law will be determined by the facts of the case, they should not be affected by the venue of the bankruptcy court.[4] If the opinion below is allowed to stand, the secured creditor's right to periodic payments or other compensation for delay will be determined as much by the venue of the case as by the facts.

The conflict among the circuits left by the opinion of the court below will lead to forum shopping similar to that condemned by this Court in *Butner v. United States*, 440 U.S. 48, 59 L.Ed.2d 136, 99 S. Ct. 914 (1979). A serious conflict among the circuits leads to forum shopping among states in different circuits; in *Butner*

---

[1] A circuit-by-circuit summary of cases decided under the Bankruptcy Code that address the issue of whether a secured creditor is or may be entitled to adequate protection for the "time value" of its interest in collateral is included in Appendix H, at 159a. Lower court decisions in the Fourth, Fifth, Eighth and Ninth Circuits are not included.

[2] *See* note 1, *supra;* Appendix H, at 159a.

[3] This division was noted by the panel opinion below. *Compare* 793 F.2d at 1411-12 & n.54 (and authorities cited) *with* 793 F.2d at 1412-13 & n.58 (and authorities cited).

[4] The Constitution allows only "uniform laws on the subject of Bankruptcies throughout the United States," U.S. Const., art. I, § 8, cl. 4. Bankruptcy legislation may, of course, recognize and enforce varying state laws that grant more valuable rights to secured creditors in some states than in others. *See Stellwagen v. Clum*, 245 U.S. 605, 613, 62 L.Ed. 507, 511, 38 S. Ct. 215 (1918). But the Constitution requires that bankruptcy courts in different parts of the country respond alike when the facts and applicable state law are the same. *See Vanston Bondholders Protective Committee v. Green*, 329 U.S. 156, 172-73, 91 L.Ed. 163, 171, 67 S. Ct. 237 (1946) (Frankfurter, J., concurring) ("The Constitutional requirement of uniformity . . . is wholly satisfied when existing obligations of a debtor are treated alike by the bankruptcy administration throughout the country, regardless of the State in which the bankruptcy court sits.").

v. United States, the Court expressed concern as to forum shopping between state and federal courts in the same state. In part to address this concern, the Court held that a mortgagee's rights to rents collected during the mortgagor's bankruptcy is to be determined by the law of the state where the property is located, and not by federal courts imposing their own interpretation of equity. As the Court explained: "Uniform treatment of property interests by both state and federal courts within a state serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy'." 440 U.S. at 55, *citing Lewis v. Manufacturers National Bank,* 364 U.S. 603, 609, 5 L.Ed.2d 323, 81 S. Ct. 347 (1961). To ensure uniformity with respect to the treatment of secured creditors' rights in property under state law, and to discourage forum shopping among bankruptcy courts in different circuits, it is imperative that the law be uniform among the circuits with respect to the protection of the time value of rights in property.

The issue of protection for the time value of secured creditors' state law foreclosure rights is too important and too frequently litigated[5] to depend upon the fortuity

---

[5] As the panel opinion pointed out, 793 F.2d at 1388 n.11, *quoting* Norton, 1984 ANNUAL SURVEY OF BANKRUPTCY LAW 197, the meaning of "indubitable equivalent" is "probably the most litigated issue in cases dealing with section 361." *See also* Note, *Recent Developments—Relief from the Automatic Stay: Section 362(d),* 3 BANKR. DEV. J. 199 (1986) ("This lack of adequate protection, as based on section 361 of the Code, has been the subject of a great deal of litigation during the past year."). Although one can question the panel opinion's assertion that *American Mariner* is the reason for the recent increase in relief from stay motions filed in the Southern District of Texas, 793 F.2d at 1408 & n.49, it is beyond dispute that the issue of compensation for lost opportunity costs is litigated literally thousands of times every year throughout the United States.

of where a bankruptcy case is filed. Even without the conflict among the circuits created by the Fifth Circuit's decision, that decision would warrant review by this Court because of the sheer magnitude of its effect. The Fifth Circuit is the home of several major financial centers, including Dallas, Houston and New Orleans. Because of the recent sharp decline in oil prices and the resulting downward effect upon land and commercial property values, the Fifth Circuit has seen a large increase in bankruptcy filings in the past eighteen months.[6] The economic malaise of the oil patch has not been limited to borrowers, however; as a result of the increase in nonperforming loans, record numbers of banks, savings and loans and other financial institutions in the region are presently being operated by state or federal regulators or are in serious danger of being declared insolvent.[7] Because the clear effect of the majority opinion is to coerce undersecured creditors into making involuntary, uncompensated loans during the pendency of the case for the sole benefit of debtors and their unsecured creditors,[8] it is no exaggeration to say that the Fifth

---

[6] This increase in bankruptcy filings was noted by both the panel opinion and the *en banc* dissent. *See* 793 F.2d at 1408-09 n.49 ("New chapter 11 and 13 filings were 90% higher in the first three months of 1986 than in the last five months of 1983."); 808 F.2d at 375 (Jones, J., dissenting) (referring to the "already beleaguered bankruptcy courts of the Fifth Circuit").

[7] *See, e.g.,* "Real Estate Decline Spurs S & L Crisis," HOUSTON POST, March 29, 1987, at E1 (reporting that "bad loans and drastic write-downs on the value of real estate caused the 275 Texas thrifts to lose at least $2.3 billion in 1986"); "Texans Are Holding Sway on Bank, S & L Regulation," WALL ST. J., Feb. 11, 1987, at 6, col. 1 (noting that Texas "had the dubious honor of leading the nation in bank failures" in 1986).

[8] *See* 808 F.2d at 382 (Jones, J., dissenting); *American Mariner, supra,* 734 F.2d at 435.

Circuit has seriously increased the risk to asset-based lenders who are already in a precarious financial position.

Moreover, the effects of the court's ruling will not be confined to the Fifth Circuit. In virtually every circuit in the United States, at least one lower court has reached the same conclusion as the court below. *See* note 1, *supra;* Appendix H, at 159a. This disorder in the lower courts can be expected to increase as a result of the decision below. The resulting uncertainty, particularly in light of the substantial costs and risks imposed upon commercial financiers by the decision below in jurisdictions in which it is followed, will tend to discourage secured lending and increase borrowing costs.[9]

This uncertainty regarding the interpretation of a federal statute potentially affecting every secured financing transaction throughout the country is intolerable, and there is no reason to wait for the conflict among the circuits to develop any further. "In structuring financial transactions, businessmen depend on state commercial law to provide the stability essential for reliable evaluation of the risks involved." *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 739, 59 L.Ed.2d 711, 730-31, 99 S. Ct. 1448 (1979). Having entered into financing arrangements on the basis of rights under state law to foreclose on and sell collateral upon default, and having depended on the Bankruptcy Code's protection of the value of those rights, the national commercial financing community must now reevaluate its loan practices in light of the increased costs and risks created by the Fifth Circuit's decision. Evaluation of the adequacy of security, as well as determination of appropriate interest rates, are necessarily affected by the decision below.

---

[9] *See generally* Jackson & Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L. J. 1143, 1147-49, 1163 (1979).

II.

THE DECISION OF THE COURT OF APPEALS LEAVES UNPROTECTED THE VALUE OF RIGHTS UNDER STATE LAW IN PROPERTY OF THE BANKRUPTCY ESTATE, IN DISREGARD OF CONGRESS' MANDATE OF "ADEQUATE PROTECTION" AND CONTRARY TO PRIOR DECISIONS OF THIS COURT.

A secured creditor has an interest in property, which like other such interests is defined by state law. "Property interests are created and defined by state law. . . . The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee. . . ." *Butner v. United States, supra,* 440 U.S. at 55. Congress has made clear, and this Court has affirmed, that while the enforcement of rights in property may be restricted in bankruptcy, nevertheless the value of those rights must be protected in bankruptcy. The opinion of the court below, by refusing to protect the time value of state law foreclosure rights, runs afoul of this Court's admonition that the value of property rights be respected in bankruptcy and that such rights not "be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Id.*

A creditor holding a security interest in property does not, of course, have the same rights as an owner of the property. But the creditor does have an interest in property, and that interest is defined by the security agreement and applicable state law. The essence of a security interest is not the right to possess and use the property itself, for the secured creditor has not set out to buy the property and does not care to use it; instead, the secured creditor has a claim to repayment of a specific debt from the property, and a right to liquidate the property and apply the proceeds to the debt. "The secured creditor's ultimate remedy is to sell the asset and thereby realize the asset's value in the marketplace. In practice, then, a secured creditor only has the right to the cash he could raise upon the sale of the property, not to any value deriving from its continued use." Baird and Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Ch. L. Rev. 97, 113-14 (1984). *See Sexton v. Dreyfus*, 219 U.S. 339, 345, 55 L.Ed. 244, 245 (1911) (Proving the secured creditor's claim as of the date of the bankruptcy petition, as required under the Bankruptcy Act of 1898, "compel[s the creditor] to realize his security and look for a new investment.").

An essential component of the secured creditor's rights therefore consists of the timing of its foreclosure. The secured creditor is entitled to foreclose at a specified time (typically when the debtor defaults), to recover the collateral proceeds and reinvest them. If, as the court below held, the Bankruptcy Code protects only the physical condition of the collateral, and does not compensate the secured creditor for preventing the exercise of these property rights during the bankruptcy proceeding, then the secured creditor is deprived of a substantial value. That value is measured by "the income lost by the secured creditor while he is stayed from re-lending the value of the collateral," 808 F.2d at 376-77 (Jones, J., dissenting), an amount which in this case the bankruptcy court found to be $42,500 per month.

It is undisputed that Congress has the constitutional authority, pursuant to the bankruptcy clause, not only to restrict the manner in which security interests are enforced but also to limit or even invalidate a security interest. U.S. Const., art. I, § 8, cl. 4. *See Butner v. United States*, *supra*, 440 U.S. at 54. But while Congress has chosen to restrict the secured creditor's ability to enforce its property rights during a bankruptcy case, Congress has also chosen to protect the *value* of those property rights. The House report on the bill that became the Bankruptcy Code emphasizes this protection in a passage that deserves repeating:

> [Section 361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. *Secured creditors should not be deprived of the benefit of their bargain.* There may be situations in a bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. *Though the creditor might not receive his bargain in kind, the purpose of the section is to ensure that the secured creditor receives in value essentially what he bargained for.*

H. Rep. No. 595, 95th Cong., 1st Sess. (1977), at 339 (emphasis added). *See also* S. Rep. No. 989, 95th Cong., 2nd Sess. (1978), at 53 ("Though the creditor might not be able to retain his lien upon the specific collateral held at the time of filing, the purpose of [section 362(d)] is to insure that the secured creditor receives the value for which he bargained.").

No similar statements are made in the legislative history concerning unsecured creditors. It could not be said that unsecured creditors are entitled "to the benefit of their bargain," for unsecured creditors may have their claims reduced and paid over time, and perhaps discharged entirely. But the secured creditor is more than a claimant, for such a creditor has bargained for an interest in property. The secured creditor's rights in property, like all other rights in property, is defined by state law; the Bankruptcy Code may vary the enforcement of such rights but nevertheless protects their value.

The Bankruptcy Code's protection of the value of the secured creditor's interest in property was recognized by this Court in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 76 L.Ed.2d 515, 103 S. Ct. 2302 (1983). The issue in *Whiting Pools* was the reach of the turnover provision, 11 U.S.C. § 542, as to property in the possession of a creditor holding a security interest in the property. The United States, which claimed a lien on all the property of the bankruptcy estate and had taken possession of the property prior to the institution of the bankruptcy case, contended that property no longer in the possession of the debtor was not "property of the estate" and therefore was not subject to turnover. The Court acknowledged that, under applicable non-bankruptcy law, the United States had a right to possession of the property. The Court held that section 542 modified that "procedural" right, however, by granting to the bankruptcy estate "a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of reorganization proceedings." 462 U.S. at 206-07. But the Court did not hold that the *value* of this possessory right to the secured creditor was impaired by bankruptcy law; to the contrary, the Court emphasized that this procedural right had been *replaced* by other procedural rights in bankruptcy, including the right to adequate protection: "The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights replace the protection afforded by possession." 462 U.S. at 207. Thus, section 542 allows turnover to the trustee only of such property that the trustee may use, sell or lease; pursuant to Bankruptcy Code section 363(e), 11 U.S.C. § 363(e), the bankruptcy court must prohibit or condition such use, sale or lease "as is necessary to provide adequate protection" of the secured creditor's "interest in property used, sold, or leased." As the Court explained, the creditor "with a secured interest in property included in the estate must look to this provision for protection, rather than to the non-bankruptcy remedy of possession." 462 U.S. at 204.

If the secured creditor's right to adequate protection in bankruptcy replaces the creditor's right to possession of property under non-bankruptcy law, then adequate protection must be comparable to possession in some meaningful sense. The secured creditor does not, of course, want to possess the property for personal use, nor is the secured creditor interested in the preservation or security of the property for its own sake. The secured creditor seeks only the economic benefit of the property, which if repossessed and sold at foreclosure sale will allow the creditor to recover a part of its debt. The automatic stay prevents the exercise of this right for a period of time, causing a permanent loss to the secured creditor of the income that could have been earned during that period on the reinvested collateral proceeds. Thus, the bankruptcy court in *Whiting Pools* did not protect merely the liquidation value of the property, which the court held was $35,000; instead, the bankruptcy court conditioned the debtor's use of the property on the immediate payment of $20,000 plus monthly payments of $1,000 "until the taxes were satisfied." 462 U.S. at 201, n. 7.

The ruling of the court below, in refusing to protect the time value of secured creditors' rights in property, creates a marked anomaly: the debtor and its unsecured creditors (not secured creditors) must pay the administrative costs of the bankruptcy, including payment to parties for the value of post-petition use of their property, but need not pay secured creditors for the post-petition use of property in which they have valuable rights. The operation of a debtor's business under the Bankruptcy Code imposes various costs; these include attorneys, accountants and other professional fees, the price of goods and services purchased post-petition to operate the business, and rentals for the post-petition lease of real properties used in the business. The Bankruptcy Code creates an administrative priority but not a security interest for the payment of all these post-petition costs; accordingly, these costs are borne by the debtor and its unsecured creditors, since administrative priorities are paid before unsecured and equity claims. *See* 11 U.S.C. §§ 503(b), 507(a)(1), 726. Indeed, the debtor must "timely" pay all rentals for nonresidential real property it uses post-petition, as required by the terms of the lease. 11 U.S.C. § 365(d)(3). These costs are *not* borne by secured creditors, who are entitled to the full value of their security interests, without deduction for administrative or other post-petition costs. *See* 11 U.S.C. § 725 (requiring disposition of the security in a liquidation case);

11 U.S.C. § 1129(b)(2)(A) (requiring payment of the present value of security interests in a reorganization plan). This Court has recognized that this allocation of costs to equity and unsecured claimants is a sensible way to charge the costs of operating in bankruptcy to those who are likely to benefit thereby. *See Reading Co. v. Brown*, 391 U.S. 471, 478, 482, 206 L.Ed.2d 751, 88 S. Ct. 1759 (1968) (justifying administrative expense priority for post-petition tort claims on the rationale that "those for whose benefit the business is carried on" should pay its costs). *See generally* Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BK. L. J. 399, 411-17 (1986).

A very real cost is imposed when property in which a party holds a security interest is retained by the bankruptcy estate: income that could have been earned on the reinvested proceeds of the security is forever lost. As the bankruptcy court explained in this case: "Because time runs inexorably, and because money has a time use value, *someone will fund* the time use value of an undersecured debt if the stay remains in force." 49 B.R. at 459. The question is not whether there is a cost, but "*who* will fund it: debtor or creditor." *Id.* If this cost is not paid by the debtor and its unsecured creditors, then it will ultimately be borne by the secured creditor in the form of "lost time value" or "lost opportunity costs". The ruling of the court below, contrary to long-established principles, imposes these post-petition costs on the secured creditor. The court openly acknowledges this result, citing "the rule that all creditors generally share some of the risk in a reorganization proceeding". 793 F.2d at 1382, 1410-11. Judge Clark, in his concurring opinion, goes so far as to state that neither secured nor unsecured creditors "has rights superior to the other." 808 F.2d at 374. These pronouncements are wholly unsupported and are contrary to the actual allocation of costs under the Bankruptcy Code.

Fundamentally, the error of the court below is its failure to protect the value of state law rights in property, contrary to Congress' mandate of "adequate protection" and contrary to prior decisions of this Court. Thus, the court directs its analysis to the secured creditor's "allowed claim", 793 F.2d at 1385-87, and holds that this claim is not entitled to "periodic post-petition interest payments", 793 F.2d at 1381, 1385-87, 1416. Nowhere does the court below address the value of the secured creditor's rights in property—that is, the value of the right to foreclose on property at a given point in time and to reinvest the collateral proceeds. Under applicable state law, the secured creditor is entitled to the economic benefits of the property in which it holds a security interest, including the income that may be earned on the reinvested collateral proceeds. While the procedural right to take possession of the property and foreclose its security interest is automatically stayed in bankruptcy, the secured creditor instead is entitled to "adequate protection" of its interest in property. This interest in property of the bankruptcy estate cannot be "adequately protected" in any meaningful sense if the time value of rights in property is ignored.

CONCLUSION

WHEREFORE, United Savings Association of Texas, Petitioner, prays that a writ of certiorari issue from This Honorable Court to review the judgment of the United States Court of Appeals for the Fifth Circuit in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.* In the event that the petition is granted, Petitioner prays that the judgment of the court below be reversed, and that the cause be remanded with directions to affirm the judgment of the District Court for the Southern District of Texas.

Respectfully submitted,

H. MILES COHN
SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700

Attorneys for Petitioner

CERTIFICATE OF SERVICE

I hereby certify that on the 3rd day of April, 1987, three (3) copies of the Petitioner's Petition for Writ of Certiorari were mailed, postage prepaid, to Leonard H. Simon, Pendergraft, Elam & Simon, 1400 Post Oak Blvd., Suite 600, Houston, Texas 77056. All parties required to be served have been served. I am a member of the Bar of this Court.

H. MILES COHN

APPENDIX

APPENDIX A

In re TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD., Debtor.

UNITED SAVINGS ASSOCIATION OF
TEXAS, Movant-Appellee
Cross-Appellant,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Respondent-Appellant
Cross-Appellee.

NO. 85-2678.

United States Court of Appeals,
Fifth Circuit.

Jan. 9, 1987.

Secured creditors moved for relief from automatic stay or for adequate protection. The Bankruptcy Court, Wesley W. Steen, J., sitting by temporary assignment, 49 B.R. 454, required debtor to pay monthly amount to taxes and interest escrow, and make monthly payment for adequate protection of foreclosure, and appeal was taken. The United States District Court for the Southern District of Texas, James DeAnda, J., affirmed, and appeal was taken. The Court of Appeals, 793 F.2d 1380, reversed and remanded by panel opinion. After granting rehearing en banc and vacating panel opinion, the Court of Appeals, Randall, Circuit Judge, held that provisions for adequate protection of secured creditors, in Bankruptcy Code, did not require periodic postpetition payments for interest or lost opportunity cost to undersecured creditor to compensate it for delay of reorganization proceeding during pendency of automatic stay.

Panel opinion reinstated.

Clark, Chief Judge, concurred and filed opinion.

Edith Hollan Jones, Circuit Judge, dissented and filed opinion in which Gee, Jolly, Patrick E. Higginbotham, and W. Eugene Davis, Circuit Judges, joined.

Leonard H. Simon, Daphne L. Levey, Timothy J. Henderson, Houston, Tex., for respondent-appellant cross-appellee.

Thomas H. Jackson, Cambridge, Mass., amicus curiae.

H. Miles Cohn, Houston, Tex., for movant-appellee cross-appellant.

Appeals from the United States District Court for the Southern District of Texas.

Before CLARK, Chief Judge, GOLDBERG, GEE, RUBIN, REAVLEY, POLITZ, RANDALL, JOHNSON, WILLIAMS, GARWOOD, JOLLY, HIGGINBOTHAM, DAVIS, HILL, and JONES, Circuit Judges.

RANDALL, Circuit Judge:

The court granted rehearing en banc of this appeal to consider whether the adequate protection provisions of the Bankruptcy Code of 1978, 11 U.S.C. §§ 362(d)(1) and 361, can be construed to require a Chapter 11 debtor to provide an undersecured creditor with payments during the pendency of the automatic stay representing

interest on the value of the secured creditor's collateral or compensation for the lost opportunity of reinvesting the proceeds of such collateral. The panel opinion, 793 F.2d 1380 (5th Cir. 1986), which held that the adequate protection provisions cannot be so construed, was vacated when the court decided to hear the appeal en banc.

I.

We hold today that the adequate protection provisions of the Bankruptcy Code,[1] §§ 362(d)(1) and 361, do not require periodic postpetition payments for interest or lost opportunity cost to an undersecured creditor to compensate it for the delay of the Chapter 11 reorganization proceeding during the pendency of the automatic stay. The panel opinion is reinstated.

Legislative Postscript

We review briefly the legislative proceedings relevant to adequate protection that have taken place since the enactment of the Bankruptcy Code in 1978.

The Bankruptcy Code has been amended twice since its enactment. The Bankruptcy Amendments and Federal Judgeship Act of 1984 was enacted primarily to deal with the Supreme Court's 1982 decision in *Northern Pipeline Co. v. Marathon Pipe Line Co.,* 458 U.S. 50, 102 S. Ct. 2858, 73 L.Ed.2d 598 (1982). Congressional action on the 1984 amendments was completed on June 29, 1984, and the amendments were signed into law by the President on July 10, 1984. *See* Pub.L. No. 98-353, 98 Stat. 333, 392 (1984). The 1984 legislation effected no changes in the adequate protection provisions of the Bankruptcy Code. Significantly, *American Mariner* was not decided until June 4, 1984; the vast majority of bankruptcy court decisions prior to that time, as well as the bankruptcy appellate panel decision in *American Mariner* —those being the decisions on the books during most of the time that Congress was considering the 1984 amendments—refused to construe the adequate protection provisions to require the payment of interest or lost opportunity costs.[2]

---

[1] Terms defined in the panel opinion are used herein as therein defined.

Commencing in 1985, several bills concerned with the family farm bankruptcy problem were filed in Congress.

---

[2] In 1981, the House Subcommittee on Courts, Committee on the Judiciary, held hearings on the effect of the Bankruptcy Reform Act of 1978. These hearings, which are included in the legislative history of Pub. L. No. 98-353, were in the nature of oversight; they did not concern any particular pending legislation. The automatic stay was discussed only twice in the course of those proceedings. Richard Levin, an attorney on the staff of the House Judiciary Committee, stated:

> [T]he new automatic stay of § 362 and the provisions for relief from the stay appear to be working well. The compromises that were forged in that area after extensive discussion and debate seem to protect the interests involved, by insuring reasonably expeditious and fair resolution of automatic stay disputes.

Hearings on The Bankruptcy Reform Act of 1978 Before the Subcomm. on Courts of the Senate Comm. on the Judiciary, 97th Cong., 1st Sess. 312 (1981). Another witness, Lloyd D. George, Bankruptcy Judge for the District of Nevada, stated that "[t]he standards for granting relief from the automatic stay provisions of 11 U.S.C. 362, the times for filing plans, and even the types of procedures available to particular creditors are much clearer under the new code." *Id.* at 206. He continued by observing that most of those whose interests lay on the side of the creditor "thought that the drafters of the code had struck a reasonable balance between the conflicting interests of debtors and their creditors." *Id.* at 207.

These statements were made in April 1981, at a time when no court had espoused, in a published opinion, the position adopted three years later by the Ninth Circuit in *American Mariner*. No proposed amendments to §§ 361 or 362(d) arose out of these hearings.

Proceedings on these bills culminated in the enactment of the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub.L No. 99-554, 100 Stat. ____ (1986) (H.R. 5316) [hereinafter cited as *Family Farmer Bankruptcy Act of 1986*], which was signed by the President on October 27, 1986. In the course of the hearings on family farm bankruptcies, numerous witnesses testified about the impact of the *American Mariner* decision on the reorganizability of farm debtors. *American Mariner* was resoundingly criticized by virtually all who testified. The pervasive sentiment expressed by those who addressed the various family farm brankruptcy proposals before Congress was that the *American Mariner* requirement of payment of interest or lost opportunity costs as a form of adequate protection to secured creditors was almost invariably fatal to the family farmer's prospects for reorganization; it is the rare family farm debtor who can make the lost opportunity cost payments required under *American Mariner*.[3] Additionally, the *American Mariner* result was critized for diverting the debtor's resources and attention away from

---

[3] In November 1985, the Subcommittees on Administrative Practice and Procedure, and Courts, Senate Committee on the Judiciary, held hearings on the family farm bankruptcy problem. In his comments to the subcommittees regarding various proposals before the Senate, Richard F. Stageman, Bankruptcy Judge for the Southern District of Iowa, observed that:

> [A] farmer is forced to compensate creditors for the delay in the enforcement of their rights caused by the Chapter 11 created "breathing space". *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984). The Eighth Circuit has adopted this burdensome concept in *In re Martin*, 761 F.2d 472 (8th Cir. 1985). . . .
>
> . . . .
>
> Unfortunately, the vast majority of farm debtors are unable to provide creditors with adequate protection under the *Martin* analysis. Judge Fagg speaking for the *Martin* court states that "the concerns we express are not insurmountable" to which I as a work-a-day bankruptcy judge would offer—neither is Mount Everest.

The Question of the Remedies Available to Debtors and Creditors under Bankruptcy, How they Relate to the Great Plight of the American Farm and the Farm Family: Hearings Before the Subcomms. on Admin. Practice and Procedure, and Courts of the Senate Comm. on the Judiciary, 99th Cong., 1st Sess. 51-52 (1985) [Hereinafter cited as *Farm Family Hearings*]. In his prepared statement to the subcommittees, Judge Thomas M. Moore, Bankruptcy Judge in the Eastern District of North Carolina, echoed this sentiment:

> At least two Circuit Courts of Appeal have held that "adequate protection" requires the debtor to compensate the secured creditor for "lost opportunity costs" in those cases where the value of the collateral is less than the amount of debt secured by the collateral. *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984); *Grundy National Bank v. Tandem Mining Corporation*, 754 F.2d 1436 (4th Cir. 1985). . . .
>
> Our district is in the Fourth Circuit and payment for "lost opportunity costs" is required for adequate protection where the value of the collateral is less than the amount of the secured debt owed the creditor. However, the farmers in our district are unable to pay "lost opportunity costs." In fact, most of them are unable to pay an attorney a reasonable retainer for filing the petition. This requirement for the payment of "lost opportunity costs" is the first and one of the biggest obstacles faced by the farmer-debtor. Unless the requirement for payment of "lost opportunity costs" is modified, the farmer in our district will not have the time to formulate and file a plan of reorganization.

Id. at 177-78.

Bankruptcy attorney R. Fred Dumbaugh commented to the subcommittees that

> [t]he Farmer-Debtor's case can . . . be 'won or lost' at a very early stage in the reorganization efforts, depending upon the outcome of stay litigation. Given the recent trend in case law interpretation of the requirements of adequate protection, the risk to the Farmer-Debtor increases each day. *See, In Re American Mariner Industries*, 734 F.2d 426 (9th Cir. 1984).

Id. at 117. William L. Needler, another bankruptcy attorney, suggested that "Congress should specifically overrule the *American Mariner* case and *Lend Lease v. Briggs Transportation Co.*, Civ. 3-84-224 (D. Minn. Sept. 26, 1984), both of which set impossible guidelines for adequate protection in reorganization proceedings." *Id.* at 267-68.

the important task of plan formulation; the debtor is forced to spend his time and money in battling motions to lift the automatic stay.[4]

Several of those who addressed the family farm bankruptcy problem described the result of *American Mariner* as not being faithful to the legislative intent embodied in the adequate protection provisions of the 1978 Bankruptcy Code. For example, an article critical of the *American Mariner* decision was included by Senator Grassley in the Congressional Record for October 3, 1986, the day the Senate considered the conference report on H.R. 5316. The author of that article concluded:

> [T]his writer believes that *American Mariner* was incorrectly decided. . . . [T]he Court held that the undersecured creditor must receive the "indubitable equivalent" of its entire bargain under section 361 (3), which was erroneously construed by the Court

---

[4] A bankruptcy practitioner described the situation as follows:

> [A] great deal of the time and resources of the Farmer-Debtor are spent in negotiations and litigation involving stay motions. By a large margin, stay motions consume more time and resources of the Debtor than any other aspect of the case. . . . In many cases, a motion for relief from the automatic stay is a "knee-jerk" reaction to the filing of the Bankruptcy Petition. Many creditors see stay motions as a way to defeat the reorganization effort at an early stage, or to demand a "larger chunk of the pie" than they might otherwise get had no stay motion been filed.
>
> The reason why the Farmer-Debtor must spend so much time and resources in combating stay litigation is that there is so much "at risk" for the Farmer-Debtor should the movant prevail in having the automatic stay terminated. . . . Given the recent trend in case law interpretation of the requirements of adequate protection, the risk to the Farmer-Debtor increases each day. *See, In re American Mariner Industries*, 734 F.2d 426 (9th Cir. 1984).

Farm Family Hearings, *supra*, at 116-17 (statement of R. Fred Dumbaugh).

of Appeals for the Ninth Circuit to include the present value of the creditor's state law rights to foreclose its collateral (and liquidate it) and reinvest the proceeds. . . .

The Committee on Stays, Executory Contracts, and Property of the Estate for the National Bankruptcy Conference took issue initially with the *American Mariner* decision, arguing that the decision: (1) ignores the language of section 361 in general and section 361(3) in particular, which speaks of "adequate protection" of and the "indubitable equivalent" of the secured creditor's interest in *its collateral;* (2) misreads the House and Senate Reports, which make no reference (as admitted by the Court) to the "secured creditor's legal right to take possession of and sell the collateral" or its "equitable right to reinvest the proceeds of the sale," 734 F.2d at 430-1, which were written before the *indubitable equivalent* language was incorporated in section 361(3). . . . This committee's recommendations are subject to further analysis before the National Bankruptcy Conference takes an official position for or against the committee's recommendations and arguments. However, this writer believes that the arguments of the committee are correct and highlight the errors in the rationale of the *American Mariner* decision.[5]

---

[5] Additionally, the author noted that the Committee felt that the *American Mariner* decision

> (3) erroneously equates "indubitable equivalent" of the secured creditor's interest *in the collateral* in section 361(3) to "indubitable equivalent" of *the secured claim* in section 1129(b)(2)(A)(iii), where the latter phrase appears as an alternative to the discounted present value "as of the effective date of the plan" of deferred cash payments under the plan; (4) ignores the statutory scheme, which is that adequate protection under section 361 [with the back-up of super priority under section 507(b)] was designed to preserve only the value of the secured creditor's interest *in the collateral* in order to fix the amount of the secured claim, which must then be fully compensated by

132 Cong. Rec. S15090 n. 187 (daily ed. Oct. 3, 1986) (article by John C. Anderson) (emphasis in original).[6]

> present value under the plan, whether the plan is confirmed under section 1129(a)(7) or under section 1129(b)(2)(A); (5) allows an undersecured creditor to obtain, early in the proceeding, the full value of its claim on the encumbered collateral, although the value of the unsecured creditors' claims on unencumbered collateral remains at risk throughout the case; and, at the same time, gives the undersecured creditor postpetition interest on the secured part of its claim by way of adequate protection, although section 506(b) does not allow any postpetition interest as part of the secured portion of the undersecured claim; (6) will jeopardize many reorganizations by enabling secured creditors to obtain, early in the Chapter 11 case, the full value of their claims, whereas the statutory scheme requires that they receive that value only on confirmation of a plan.

132 Cong. Rec. S15090 n. 187 (daily ed. Oct. 3, 1986) (article by John C. Anderson) (emphasis in original).

[6] In the same article, the author described the "growing trend of cases interpreting the legislative history of the Code to require a more stringent standard of indubitable equivalence than this writer believes is consistent with the spirit of reorganization concepts," and cited *American Mariner* as an example. 132 Cong. Rec. S15085 (daily ed. Oct. 3, 1986) (article by John C. Anderson).

During the hearings before the Subcommittees on Administrative Practice and Procedure, and Courts, Senate Committee on the Judiciary, one witness noted that:

> Recently, adequate protection has also been interpreted to require payments to secured creditors based upon opportunity cost. *See, In Re American Mariner*, 734 F.2d 426 (9th Cir. 1984). . . .
>
> . . . However, interest payments to an undersecured creditor seems inconsistent with § 506(b) of the Code, which provides for the accrual of post-petition interest only if the collateral is worth more than the debt.
>
> Some courts have seen this apparent inconsistency as sufficient grounds for refusing to order adequate protection payments for opportunity cost. *See, In Re South Village, Inc.*, 25 B.R. 987 (1982). . . .
>
> The reports accompanying the Bankruptcy Code support the *South Village result*. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 339 (1977), U.S. Code Cong. & Admin. News, P. 6295; S. Rep. 95-989, 95th Cong., 2nd Sess. 54 (1978), U.S. Code Cong. & Admin. News, P. 5840. These reports indicate Congress

Amendment of the adequate protection provisions to allevate the impact of the *American Mariner* decision and its construction of the adequate protection provisions was seen by most who testified as critical if family farm reorganizations were to have any chance of success.[7] As Senator Grassley, in concluding the hearings on the family farm bankruptcy problem, stated:

> I envision changes to those terms in the code such as "adequate protection" that have been applied in a restrictive manner, making farmer reorganizations unreasonably difficult.

> had in mind the protection of loss in value of the collateral due to depreciation in that value. Perhaps Congress should now make that intention explicit by amending § 361 to § 363 to exclude adequate protection for opportunity cost.

Farm Family Hearings, supra, at 250-51 (statement of Terry M. Anderson).

[7] In a statement submitted at the hearings on the family farm bankruptcy problem, one witness urged that "[t]he provisions of section 361 . . . be amended to clarify the adequate protection definition," *Farm Family Hearings, supra,* at 266 (statement of William L. Needler), and went on to suggest that "[t]he Code should . . . be changed to make it clear that the decision of the 9th Circuit Court of Appeals in *American Mariner,* 734 F.2d 426, 1984 is abolished." *Id.* at 267. Echoing this sentiment, another witness suggested that "[p]erhaps Congress should now make [its] intention [to protect the loss in value of the collateral due to depreciation in that value] explicit by amending § 361 to § 363 to exclude adequate protection for opportunity cost." *Id.* at 251 (statement of Terry Anderson).

As might be expected, a representative of the Independent Bankers Association of America stated:

> [W]e support the *American Mariner* decision since it strikes an appropriate balance between the right of a debtor to secure a "breathing space" from his creditors through the automatic stay and the right of a creditor to receive compensation for being unable to demand prompt payment or to foreclose and take possession of the collateral. Congress does not need to take further action on this issue.

Id. at 156 (statement of John C. Dean).

> I believe we need to correct restrictive court interpretations in a way that frees up the use of cash collateral and helps to stave off attempts to lift the automatic stay.

Farm Family Hearings, supra, at 289.

The 1986 legislation that resulted from the congressional hearings amended the Bankruptcy Code by adding a new Chapter 12 to deal with family farm bankruptcies. In most respects, the new Chapter 12 is modeled on Chapter 13. The principal relief which it affords family farmers, who had previously been forced to seek relief under Chapter 11, is to eliminate the impact of the absolute priority rule on the family farm debtor. In many farm bankruptcies, the absolute priority rule gave the unsecured creditors the power to prevent confirmation of a plan if the debtor continued to have any equity interest in his farm. *See* 11 U.S.C. § 1129(b)(2)(B). Under the new Chapter 12, as under Chapter 13, the vote of unsecured creditors is not required for the confirmation of a plan of reorganization. Additionally, under the new Chapter 12, the family farmer can overcome an unsecured creditor's objection to confirmation by demonstrating that "the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim." *Family Farmer Bankruptcy Act of 1986,* § 1225(b)(1)(A) (to be codified at 11 U.S.C. § 1225(b)(1)(A)). Alternatively, the unsecured creditor's objection can be overcome if "the plan provides that all of the debtor's projected disposable income to be received in the three-year period, or such longer period as the court may approve under section 1222(c), beginning on the date that the first payment is due under the plan will be applied to make payments under the plan." *Family Farmer Bankruptcy Act of 1986*, § 1225(b)(1)(B) (to be codified at 11 U.S.C. § 1225(b)(1)(B)).

The new Chapter 12 also amends the adequate protection provisions as they apply to family farmers by making § 361 inapplicable in family farm reorganization cases brought under Chapter 12, and by setting forth, in § 1205, the forms that adequate protection can take in family farm reorganization. *Family Farmer Bankruptcy Act of 1986*, § 1205 (to be codified at 11 U.S.C. § 1205).[8] Significantly, § 1205 sanctions, as a form of

---

[8] Section 1205 provides:

"(a) Section 361 does not apply in a case under this chapter.

"(b) In a case under this chapter, when adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—

"(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

"(2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of property securing a claim or of an entity's ownership interest in property;

"(3) paying to such entity for the use of farmland the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property; or

"(4) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will adequately protect the value of property securing a claim or of such entity's ownership interest in property.

Family Farmer Bankruptcy Act of 1986, § 1205 (to be codified at 11 U.S.C. § 1205).

adequate protection, payment by the Debtor for the use of farmland of "the reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property." *Family Farmer Bankruptcy Act of 1986*, § 1205 (to be codified at 11 U.S.C. § 1205). The expectation is that this will result in payments by the debtor to secured creditors that are significantly smaller than those that would have obtained under *American Mariner*. As the conference report accompanying H.R. 5316 notes:

> Lost opportunity costs payments present serious barriers to farm reorganizations, because farmland values have dropped so dramatically in many sections of the country—making for many undercollaterialized [sic] secured lenders. Family farmers are usually unable to pay lost opportunity costs. Thus, family farm reorganizations are often throttled in their infancy upon motion to lift the automatic stay.
>
> Accordingly, section 1205 of the conference report provides a separate test for adequate protection in Chapter 12 cases. It eliminates the need of the family farmer to pay lost opportunity costs, and adds another means for providing adequate protection for farmland—paying reasonable market rent. Section 1205 eliminates the "indubitable equivalent" language of 11 U.S.C. 361(3) and makes it clear that what needs to be protected is the value of property, not the value of the creditor's "interest" in property.
>
> It is expected that this provision will reduce unnecessary litigation during the term of the automatic stay, and will allow the family farmer to devote proper attention to plan preparation.

H. R. Conf. Rep. No. 958, 99th Cong., 2d Sess. 49-50, *reprinted in* 1986 U.S. Code Cong. & Ad. News 5227, 5246, 5250-5251.

A few significant conclusions can be drawn from the action of Congress in 1986. The first is that virtually all witnesses testifying at the hearings, and Congress itself, recognized the disastrous impact of *American Mariner* on the family farmer's reorganization prospects. The second is that Congress, although believing that some form of adequate protection of the interest of certain secured creditors (those with a security interest in farmland) was in order, chose to effectuate that adequate protection by means of an amendment to the statute that tied the protection to the use of the farmland and to comparable rental values and the net income of the debtor. This gives the bankruptcy judge the flexibility to award some compensation to the secured creditor without destroying the debtor's prospects for reorganization.

The enactment of § 1205, making § 361 inapplicable to family farm reorganization cases and providing for rental payments as adequate protection, is an example of the legislative process at work. Congress held hearings during which witnesses representing various interest groups testified. With few exceptions, those witnesses excoriated the *American Mariner* result. After considering the testimony, Congress made the decision legislatively to overrule *American Mariner* in the context before it—that of family farm bankruptcies. What resulted reflects a compromise based on the consideration of the often competing interests of the debtor, the secured creditors, and the unsecured creditors.

This history of § 1205 stands in stark contrast to the legislative history of the Bankruptcy Code. In the course of the extensive hearings leading up to the 1978 enactment, there is no evidence of the legislative process at work with respect to the problem of compensation for delay. Adequate protection payments for lost opportunity or interest were never discussed.

Doubtless the argument will be made that the enactment of § 1205, with the avowed congressional purpose of relieving the family farmer of the impact of the *American Mariner* decision, represents an endorsement of the *American Mariner* result with respect to all other debtors. For several reasons, this argument must be rejected.

To begin, § 1205 was introduced to overcome the impact on family farm debtors of the *American Mariner* court's construction of the adequate protection provisions of the Bankruptcy Code. The introduction of the family farm bill hardly suggests that its sponsors viewed *American Mariner* as a correct interpretation of the adequate protection provisions. *Cf. Russello v. United States,* 464 U.S. 16, 25-26, 104 S. Ct. 296, 301-02, 78 L.Ed.2d 17 (1983) ("[T]he bills . . . were introduced in order to overcome the decisions in [United States v.] *Marubeni* [American Corp., 611 F.2d 763]. [United States v.] *Meyers* [432 F.Supp. 456]. and [United States v.] *Thevis* [474 F.Supp. 134]. . . . The introduction of these bills hardly suggests that their sponsors viewed those decisions as correct interpretations of [18 U.S.C.] § 1963 (a)(1)."); *United States v. Gordon,* 638 F.2d 886, 888 n. 5 (5th Cir.), *cert. denied,* 452 U.S. 909, 101 S. Ct. 3038, 69 L.Ed.2d 411 (1981).

Additionally, the fact that Congress chose legislatively to overrule *American Mariner* only with respect to family farmers cannot support a construction of § 1205 as a congressional endorsement of *American Mariner* in other contexts. *Cf. United States v. Price,* 361 U.S. 304, 310, 80 S. Ct. 326, 330, 4 L.Ed.2d 334 (1960).[9] Indeed, to read the bill as an endorsement of *American Mariner* would stand the legislative history of the family farm bill's adequate protection provision on its head. Too many of those who addressed the adequate protection problem in the congressional hearings assailed the *American Mariner* result. The fact that Congress legislatively overruled *American Mariner* only with respect to family farmers simply reflects the fact that Congress was responding to a specific problem—that of family farm bankruptcies—with a bill of limited scope.[10] Simply stated, the 1986 enactment was farm bankruptcy legislation, not a comprehensive overhaul of the provisions of the Bankruptcy Code.

The enactment of the family farm bankruptcy legislation clearly illustrates the fact that Congress is uniquely suited to address the question of compensation for delay by Chapter 11 debtors generally. All creditors, unsecured as well as secured, are stayed from seizing the debtor's property to satisfy their claims and are adversely affected by the delay of the reorganization process. If some or all of these creditors are to be compensated for the debtor's use of property to which they are looking for payment or for delay, that decision (and the related decision regarding whose assets would fund that compensation) should emerge from the legislative process in which competing interests can be evaluated and compromises reached. In the meantime, it is the role of the courts to effectuate those provisions of the Bankruptcy Code that Congress has already enacted to protect creditors and to reduce delay. To those we now turn.

II.

United contends that our interpretation of the adequate protection provisions of the Bankruptcy Code effectively precludes an undersecured creditor whose collateral is not depreciating from ever obtaining relief from the automatic stay to enable it to enforce its rights in the collateral. This assertion ignores important provisions of the Bankruptcy Code which are designed to protect the secured creditor.

---

[9] In *Price,* the Supreme Court considered whether a subsequent legislative development changed its view of § 272(a)(1) of the Internal Revenue Code. The subsequent legislative development at issue was the failure of Congress to adopt a House subcommittee recommendation to expressly repudiate certain court decisions. The Supreme Court stated that "[t]his recommendation was not adopted, and from the failure to act, respondent would have us infer an acceptance by Congress of the Ninth Circuit's position. Such nonaction by Congress affords a most dubious foundation for drawing positive inferences." 361 U.S. at 310-11, 80 S. Ct. at 330.

[10] Throughout the proceedings during which various family farm bankruptcy proposals were considered, the emergency nature of the problem and the limited scope of the proposed solutions were recognized. *See, e.g., Farm Family Hearings, supra,* at 2 (statement of Sen. John P. East) ("The problem we are confronted with today is a depression on the American farm. I do not think it is an exaggeration to say a depression. We are trying to be responsive to that compelling need. . . . What we hope to do here this morning is to begin a modest venture of seeking possible avenues to relieve this financial burden on the family farm."); *Id.* at 27 (statement of Rep. Mike Synar) ("It is critical that the problems of the Bankruptcy Code be worked out soon because, as we all know, the farm crisis is getting worse. . . . [The bill] does not attempt to overhaul the Bankruptcy Code or alter existing policies."); *Id.* at 59 (statement of Richard Stageman) ("[T]hese amendments . . . designed to treat a special group in a unique situation. . . ."); 132 Cong. Rec. S15075 (daily ed. Oct. 3, 1986) (statement of Sen. Thurmond) ("The family farm provisions of [H.R. 5316] are an extraordinary response to what is, hopefully, a temporary crisis."); 132 Cong. Rec. H9001 (daily ed. Oct. 2, 1986) (statement of Rep. Fish) ("A new chapter 12 for family farmers, patterned in a number of respects after existing chapter 13, is tailored specifically to the realities of a nationwide farm crisis.").

A fundamental purpose of the automatic stay is to "give[ ] the business a breathing spell and time to work constructively with its creditors" to propose a plan of reorganization. H.R. Rep. No. 595, 95th Cong., 2d Sess. 174, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6135 [hereinafter cited as *House Report*]. The continuance of the automatic stay contemplates a debtor that is reorganizable and that is actively pursuing that goal. Where there is no reasonable likelihood of reorganization or where the debtor unreasonably delays in its efforts to reorganize, the Bankruptcy Code affords several avenues for relief to all creditors, secured as well as unsecured.

Significant among those avenues for relief for the secured creditor is § 362(d)(2) which entitles a secured creditor to obtain relief from the automatic stay in order to foreclose on its collateral when "the debtor does not have an equity in such [collateral]," 11 U.S.C. § 362(d)(2)(A), and "such [collateral] is not necessary to an effective reorganization." 11 U.S.C. § 362(d)(2)(B). Courts have consistently construed § 362(d)(2)(B) to require a showing by the debtor[11] that there is a reasonable possibility of a successful reorganization within a reasonable time.[12] The mere indispensability of the property to the debtor's survival and the debtor's hopes of reorganization are insufficient to justify continuation of the stay when reorganization is not reasonably possible.[13]

---

[11] Under 11 U.S.C. § 362(g), the secured creditor has the burden of proof on the issue of the debtor's equity in the property and the debtor has the burden of proof on all other issues.

---

[12] *See, e.g., In re Pacific Tuna Corp.*, 48 B.R. 74, 78 (Bankr. W.D. Tex. 1985) ("reasonable possibility of a successful reorganization of the debtor within a reasonable time"); *In re Development, Inc.*, 36 B.R. 998, 1005 (Bankr. D. Haw. 1984) ("reasonable likelihood of a successful reorganization within a reasonable period of time"); *In re Martin*, 19 B.R. 496, 498 (Bankr. E.D. Pa. 1982) ("reasonable probability that [debtor] will be able to propose a plan that will result in a successful reorganization"); *In re Dublin Properties*, 12 B.R. 77, 81 (Bankr. E.D. Pa. 1981) ("reasonable probability that [debtor] will be able to propose a plan that will result in its successful reorganization"); *In re Accent Assocs., Inc.*, 8 B.R. 933, 936 (Bankr. D. Mass. 1981) ("reasonable possibility of an *effective* reorganization within a reasonable time") (emphasis in original); *In re Terra Mar Assocs.*, 3 B.R. 462, 466 (Bankr. D. Conn. 1980) ("reasonable possibility of a successful reorganization within a reasonable time").

[13] *See, e.g., In re Albany Partners, Ltd.*, 749 F.2d 670, 673 n. 7 (11th Cir. 1984) ("[I]t must be demonstrated that an effective reorganization is realistically possible; the mere fact that the property is indispenable to the debtor's survival is insufficient."); *In re Mikole Developers, Inc.*, 14 B.R. 524, 527 (Bankr. E.D. Pa. 1981) ("debtor's high hopes for reorganization or need alone for the property is not the sine qua non under Section 362(d)(2)"); *In re Dublin Properties*, 12 B.R. at 81 ("more than a mere financial pipe dream"); *In re Clark Tech. Assocs., Ltd.*, 9 B.R. 738, 740 (Bankr. D. Conn. 1981) ("If all the debtor can offer at this time is high hopes without any financial prospects on the horizon to warrant a conclusion that a reorganization in the near future is likely, it cannot be said that the property is necessary to an 'effective' reorganization."); *In re Terra Mar Assocs.*, 3 B.R. at 466 ("'Indispensibility of the property to the debtor's survival and hope of rehabilitation is not enough . . . to justify continuation of the stay when rehabilitation is hopeless. . . .'"); *see also Grundy Nat. Bank v. Tandem Mining Corp.*, 754 F.2d 1436, 1440 (4th Cir. 1985) ("§ 362(d)(2)(B) presupposes that the property must be necessary to an '*effective*' reorganization if relief from the stay is to be properly denied." (emphasis in original).

We recognize that relief from stay hearings are usually held early in the case and that they are expedited, limited in scope, and held on limited notice. Therefore, the bankruptcy court applies the "reasonable possibility of successful reorganization" standard with somewhat more indulgence than would be appropriate if the motion were made at a later stage in the proceedings or if a similar issue were raised in the context of the full-blown hearing that attends a motion to dismiss or convert the case brought under § 1112. Nonetheless, the "effective reorganization" standard must be given meaning by the bankruptcy court. To prevail against the secured creditor who has moved to lift the stay under § 362(d)(2), the debtor must do more than evince high hopes; he must be able to show a reasonable prospect for a successful reorganization within a reasonable time.[14]

Perhaps the prime avenue for relief, for both the secured and unsecured creditors of a debtor who is not reorganizable or who is unreasonably delaying, is the motion for conversion or dismissal. Section 1112(b) of the Code provides, in relevant part, that:

> [O]n request of a party in interest, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause including—

---

[14] Because a plan of reorganization under Chapter 11 can at least since 1978, consist of a liquidation of the debtor, there may be circumstances under which the debtor is able to satisfy the "effective reorganization" test of § 362(d)(2) by showing that the property at issue is necessary to an effective liquidation of the debtor under Chapter 11, as distinguished from an effective rehabilitation of the debtor. *See generally In re Koopmans*, 22 B.R. 395 (Bankr. D. Utah 1982).

> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
>
> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to creditors;
>
> (4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
>
> . . . . .

11 U.S.C. § 1112(b). Section 1112 clearly provides the bankruptcy court with the requisite authority to terminate a Chapter 11 case based on a showing of unreasonable delay, or continuing losses coupled with the absence of a reasonable likelihood of rehabilitation, or inability to effectuate a plan of reorganization. The inquiry under § 1112 is case-specific, focusing on the circumstances of each debtor. In the case of most Chapter 11 debtors, however, a plan of reorganization can be effectuated, if at all, within a matter of months, not years. An occasional Chapter 11 debtor, for example, one with a complex debt structure or multifarious business problems, may require more time. However, the existence of such a debtor is the exception, not the rule. The charge to the bankruptcy judge under § 1112, then, is to evaluate each debtor's viability and rate of progress in light of "the best interest of creditors and the estate."

Finally, we note that Congress, in 1978, expressly recognized the problems faced by creditors of a debtor who unreasonably delays in proposing a plan of reorganization. In § 1121 of the Banckruptcy Code, Congress gave the debtor a period of 120 days, after the commencement of the Chapter 11 case, during which the debtor has the exclusive right to file a plan of reorganization. Thereafter, if the debtor has not filed a plan, any party in interest, including any creditor, may file a plan. The 120-day period may be reduced or increased for cause, on request of a party in interest, after notice and a hearing.

The limited exclusivity period which is a feature of Chapter 11 proceedings under the Bankruptcy Code contrasts with the procedure under Chapter XI of the Bankruptcy Act which gave the debtor the exclusive right, throughout the Chapter XI proceedings, to propose a plan. The House Report accompanying H.R. 8200 noted that "[t]he exclusive right [under old Chapter XI] gives the debtor undue bargaining leverage, because by delay he can force a settlement out of otherwise unwilling creditors." *House Report, supra,* at 231, U.S. Code Cong. & Admin. News 1978, p. 6191. Additionally, § 1121 represents a congressional acknowledgement that creditors, whose money is invested in the enterprise no less than the debtor's, have a right to a say in the future of that enterprise.[15]

---

[15] In explaining the purpose and function of what is now § 1121, the House Report notes:

> Proposed chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy. At the same time, the bill recognizes the legitimate interests of creditors, whose money is in the enterprise as much as the debtor's, to have a say in the future of the company. The bill gives the debtor an exclusive right to propose a plan for 120 days. In most cases, 120 days will give the debtor adequate time to negotiate a settlement, without unduly delaying creditors. The court is given the power, though, to increase or reduce the 120-day period depending on the circumstances of the case. For example, if an unusually large company were to seek reorganization under chapter 11, the court would probably need to extend the time in order to allow the debtor to reach an agreement. If, on the other hand, a debtor

While we are not called upon here to decide what factors constsitute "cause" for the extension of the exclusivity period, we think that any bankruptcy court involved in an assessment of whether "cause" exists should be mindful of the legislative goal behind § 1121. The bankruptcy court must avoid reinstituting the imbalance between the debtor and its creditors that characterized proceedings under the old Chapter XI. Section 1121 was designed, and should be faithfully interpreted, to limit the delay that makes creditors the hostages of Chapter 11 debtors.

Our brief review of the important creditor-protection provisions of the Bankruptcy Code demonstrates the inaccuracy of United's assertion that our construction of the adequate protection provisions leaves the secured creditor unable to enforce its rights. Congress clearly intended to provide a wide range of remedies for the secured creditors of a debtor that does not have a reasonable possibility of reorganizing or that unreasonably delays in its efforts to reorganize. It remains for the courts to effectuate those remedies.

III.

The creditor-protection provisions of the Bankruptcy Code reviewed in Part II of this opinion can be made meaningful only by bankruptcy judges who are equally sensitive to the need for creditor protection as to the need for protecting the debtor's right to reorganize.

> delayed in arriving at an agreement, the court could shorten the period and permit creditors to formulate and propose a reorganization plan. Again, the bill allows the flexibility for individual cases that is unavailable today.

House Report, supra, at 231-32, U.S. Code Cong. & Admin. News 1978, pp. 6191, 6192 (footnotes omitted).

A principal goal of the reorganization provisions of the Bankruptcy Code is to benefit the creditors of the Chapter 11 debtor by preserving going-concern values and thereby enhancing the amounts recovered by all creditors. The secured creditor benefits from a successful reorganization because its secured claim is valued on a going-concern basis in connection with a plan of reorganization, and the secured creditor is not compelled to liquidate its collateral at forced-sale prices. However, when there is no reasonable likelihood that the statutory objective of reorganization can be realized or when the debtor unreasonably delays, then the automatic stay and other statutory provisions designed to accomplish the reorganization objective become destructive of the legitimate rights and interests of creditors, the intended beneficiaries. In that situation it is incumbent upon the bankruptcy judge to effectuate the provisions of the Bankruptcy Code for the protection of creditors lest the judge keep the Code's word of promise to the ear of creditors and break it to their hope. The bankruptcy judge must meet head-on his obligation to decide, fairly and impartially, the hard questions.

Early and ongoing judicial management of Chapter 11 cases is essential if the Chapter 11 process is to survive and if the goals of reorganizability on the one hand, and creditor protection, on the other, are to be achieved. In almost all cases the key to avoiding excessive administrative costs, which are borne by the unsecured creditors, as well as excessive interest expense, which is borne by all creditors,[16] is early and stringent judicial

---

[16] Interest payable to the oversecured creditor is discussed in the panel opinion, 793 F.2d at 1386.

management of the case.[17] We recognize that Congress, in 1978, amended the bankruptcy laws with the intention of removing bankruptcy judges from the administration of the debtor's estate.[18] The purpose of this amendment was to insure the impartiality of the bankruptcy judge. We do not believe, however, that Congress thereby intended to relieve the bankruptcy judge of the responsibility of managing the cases before him in such a way as to promote the objectives and goals of the Bankruptcy Code. Our conclusion in this respect is strengthened by the fact that the bankruptcy court is an adjunct of the district court. District court judges function under Fed. R. Civ. P. 16 with full power and responsibility to manage their cases and with the directive to move their cases in such a way as to promote fairness to the parties and judicial economy. These responsibilities are not incompatible with their judicial function; indeed, they are at the core of it. We recognize that the line between administration of the debtor's estate that would jeopardize the bankruptcy judge's impartiality and effective case management may sometimes be a difficult one to draw. Nevertheless, we think that each bankruptcy judge is called upon to manage the cases in front of him, fairly and impartially, in such a way as to promote their orderly and prompt disposition. The difficulty in ascertaining where the line is to be drawn cannot be an excuse for a judge's abdication of his responsibility to function as a judge.

---

[17] Statistics compiled by the Administrative Office of United States Courts reflects that on a nationwide basis, only thirteen percent of the Chapter 11 cases terminated in 1985 were fully administered under Chapter 11, as distinguished from being dismissed or otherwise disposed of; in the Fifth Circuit in 1985, only five percent were fully administered. These statistics make it amply clear that in the vast majority of Chapter 11 cases, the statutory objective of reorganization cannot be realized. The challenge to the bankruptcy courts is to recognize these cases as promptly as possible and thereby to limit the administrative expense and other costs (including interest expense) borne by creditors.

[18] Congress intended, through its enactment of the 1978 Bankruptcy Code, to "separat[e] . . . the administrative and judicial functions of the bankruptcy judge," so that the bankruptcy courts could "become fair and unbiased fora." *House Report, supra*, at 49, U.S. Code Cong. & Admin. News 1978, p. 6010. "[T]he bankruptcy judge [would] no longer be the chief executive officer of the bankrupt debtor but rather [would] be restricted to the resolution of disputes in an adversary context." Klee, *The New Bankruptcy Act of 1978*, 64 A.B.A.J. 1865, 1867 (1978). "The court's role should be limited to a judicial one, that is, dispute resolving, and it should play no administrative part in the continued operations of the debtor." King, *Chapter 11 of the 1978 Bankruptcy Code*, 53 Am. Bankr. L.J. 107, 112 (1979). The House Report accompanying H.R. 8200 quoted the recommendation of the Commission on the Bankruptcy Laws of the United States " 'that the bankruptcy judges be removed from the administration of bankrupt estates and be restricted to the performance of essentially judicial functions, that is, primarily to the resolution of disputes or issues involving adversary parties and matters appropriate for judicial determination.' " *House Report, supra*, at 50-51, U.S. Code Cong. & Admin. News 1978, pp. 6011, 6012.

IV.

The district court's order is reversed to the extent that it ordered Timbers to pay $42,500 monthly for "adequate protection of foreclosure rights." This matter is remanded to the district court for further proceedings not inconsistent with this opinion.

REVERSED AND REMANDED.

CLARK, Chief Judge, concurring:

I regret that I feel compelled to add even this bit to the tens of thousands of words published in panel opinion and majority and dissenting opinions of the en banc court. So much has been written, I fear the elemental principles which should govern this case may be lost without a separate summary.

In this one-asset bankruptcy reorganization, the bankruptcy judge and the district court adopted the position that § 361 *required* that United Savings Association of Texas be paid periodic cash amounts representing lost opportunity cost because United could not foreclose its lien on the debtor's only asset.

I agree with the en banc majority that applying this mandatory construction could be error here, even though I do not agree that an award of such costs is always prohibited. I further agree that the bankruptcy judge should be reminded to adjudicate the rights of the parties before him in each case.[1]

Finally, I would give this bankruptcy court a few straightforward directions. First, look to see whether any controversy has endured the lengthy delay of the appellate process. Second, if so, then follow these basic principles in making your decision:

---

[1] By adopting the panel opinion, the en banc court appears to reject *In re Briggs Transportation Co.*, 780 F.2d 1339 (8th Cir. 1985). The panel said *Briggs* gives "little guidance" about deciding future cases. This rejection gives an uncertain sound. *Briggs* says what I perceive the majority says—each case must be decided on its own facts and circumstances.

(a) Reorganization is not a Holy Grail to be pursued at any length. Creditors are entitled to a prompt determination of efficacy.

(b) The Bankruptcy Code recognizes only two classes of creditors: secured and unsecured. Neither class has rights superior to the other.

(c) Secured creditors are secured only to the extent of the value of their security.

(d) State law gives unsecured creditors a right similar to that of the secured creditor to foreclose his lien—the right to reduce their claims to judgment and pursue collection. Both rights are equally impaired by bankruptcy proceedings.

(e) The Code neither compels nor prevents a determination that delay in realizing on security should be compensated. To the extent such compensation can be made out of the value of the security, it may be ordered; to the extent it could impair the rights of unsecured creditors, it may not.

I concur in vacating the judgment appealed from and in remanding the cause to the bankruptcy court for proper adjudication under the principles stated above.

EDITH H. JONES, Circuit Judge, with whom GEE, JOLLY, HIGGINBOTHAM, and DAVIS, Circuit Judges join, dissenting:

The issue the majority addresses is, in their view, "simply one of statutory construction." Yet this "simple" inquiry produces a monumental elaboration whose end result is to reject the reasonable construction of 11 U.S.C. § 361 reached by the Ninth Circuit, two other courts of appeals and numerous lower courts. The elaboration tends to obscure the fact that the majority have significantly modified, rather than interpreted, the adequate protection provision of the Bankruptcy Code. Like the Ninth Circuit, I find that a proper reading of § 361 requires adequate protection of a secured creditor for the bankruptcy-created delay in enforcing his lien against collateral. The conclusion reached by the majority favors extended delay in the bankruptcy process, affirmatively harms secured creditors while benefitting only debtors, and will create a rush of forum-shopping by debtors into the already beleagured bankruptcy courts of the Fifth Circuit. Because the majority have erred and the consequences of its error are profound, I respectfully dissent.

Recapitulating the legal posture of this case, Timbers' resort to relief under Chapter 11 of the Bankruptcy Code activated the automatic stay, 11 U.S.C. § 362(a), the cornerstone of bankruptcy, and prevented action by creditors to collect Timbers' outstanding debt.[1] The secured creditor sought relief from the stay "for cause, including lack of adequate protection." 11 U.S.C. § 362 (d)(1). United Savings argues that "adequate protection" requires compensation for the delay bankruptcy causes in preventing foreclosure and its ability to realize value through its collateral. Hence, if Timbers cannot provide such protection—by way of payments during bankruptcy, additional liens or guarantees or some other method—United Savings may foreclose. The bankruptcy court was persuaded by this argument, which has been adopted by three circuit courts of appeals and rejected by none prior to today's decision.[2]

---

[1] This case verges on presenting a hypothetical controversy to the court, because Timbers' present cash flow is tens of thousands of dollars less than monthly debt service payments and the likelihood that Timbers will be able to reorganize is virtually nil. This was conceded by debtor's counsel in oral argument. As no fact finding was made on that issue below, and the parties being intent on

Section 361 of the Bankruptcy Code does not expressly state that a secured creditor, as an entity with an interest in the debtor's property, must receive compensation on account of its damages for delay in foreclosing. It provides as follows:

§ 361 Adequate protection.

> When adequate protection is required under section 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property;
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or
>
> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

This Court's responsibility is to effectuate the "plain meaning" of the statutory language. *Watt v. Alaska*, 451 U.S. 259, 265-66, 101 S. Ct. 1673, 1677-78, 68 L.Ed.2d 80 (1981); *American Mariner*, 734 F.2d at 430. Unlike the majority, I find considerable support within § 361 for a requirement that adequate protection compensate a secured creditor for the delay occasioned by bankruptcy.

According to §§ 361(1) and (2), adequate protection must recompense the decrease in "value of [an] entity's interest in [the debtor's] property" where that decrease is caused by the automatic stay. Adequate protection must permit the creditor to realize the "indubitable equivalent" of his "interest in the debtor's property." § 361(3). These emphasized phrases are critical to proper interpretation of Section 361.

The majority argue that the "value of an entity's interest in the debtor's property" means the "value of the

---

achieving a definitive resolution of the adequate protection issue, I reluctantly conclude that the case should be decided by our court. It is indeed unfortunate, however, that nothing turns on the outcome of our decision in this case for these parties.

[2] *In re Briggs Transportation Company*, 780 F.2d 1339 (8th Cir. 1985); *Grundy National Bank v. Tandem Mining Corp.*, 759 F.2d 1436 (4th Cir. 1985); *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984).

collateral" and nothing more.[3] If Congress had wanted to limit adequate protection to a decline in the value of collateral, it could have done so, but it did not. Significantly, in enacting the Bankruptcy Judges, United States Trustee, and Family Farmer Bankruptcy Act of 1986 (hereafter, the "Family Farmer Act"), P.L. 99-554, Congress redefined adequate protection for creditors of farmers. Such secured creditors may receive compensation only to the extent of decreases "in the value of *property securing a claim* or of an entity's ownership interest in property." (emphasis added). 11 U.S.C. § 1205. Congress there expressly confined adequate protection to the value of the collateral. The "value of an entity's interest" in the debtor's property, a broader term, therefore, requires more careful analysis than the majority has performed.

One must consider the essential nature of a secured transaction according to state law in order to evaluate the impact of bankruptcy upon the "value" of the secured creditor's interest. In a bankruptcy case involving the rights of a secured creditor, the Supreme Court has observed that "[p]roperty interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55, 99 S. Ct. 914, 918, 59 L.Ed.2d 136, 141-42 (1979).

---

[3] The majority erroneously limit the scope of §§ 361(1) and (2) to declines in the value of the collateral due to its use, sale or lease. The subsections also protect against declines caused by the stay itself. The most pervasive damage caused by the stay, as will be seen, is the cost of delay.

A creditor ordinarily takes security because it has loaned money to a debtor in the expectation of being repaid at a later date. The security device is not the limit of its "interest" in the transaction, however.[4] The secured creditor's incentive to make the loan, and its profit, is the contract interest it will receive pending repayment of the principal. Taking collateral is but a means to accomplish this end. Absent bankruptcy, under state law, a debtor's default triggers the right of the secured creditor to obtain ownership of the collateral through foreclosure. The secured creditor then disposes of the collateral and, to the extent possible, restores its inventory of cash to re-lend at a profit.

The automatic stay in bankruptcy distorts the secured creditor's state-law rights in the collateral, not merely by denying him the "value" of the collateral as the majority contends, but also by delaying foreclosure. The cost of the delay additionally entails the income lost by the secured creditor while he is stayed from re-lending the value of the collateral. Put differently, the secured creditor is not so much deprived of a particular piece of property as he is deprived of the use of that property to obtain a certain amount of money at a certain time. The delay resulting from bankruptcy thus imposes a lost opportunity cost, measured upon the nominal value of the collateral, which would not beset the secured creditor under state law. An interpretation of § 361 that effectuates the adequate protection of the "value of the entity's interest in the debtor's property" must recognize the time-value of the secured creditor's rights.

---

[4] Protection of the collateral may be all a secured creditor is entitled to receive from a constitutional standpoint. See *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 61 S. Ct. 196, 85 L.Ed. 184 (1940); Comment, *Compensation of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. Chi. L. Rev. 305, 310 (1983).

The majority do not deny that lost opportunity cost is a real, measurable damage inflicted on a secured creditor by the delay inherent in bankruptcy proceedings. Nonetheless, their lengthy exegesis of pre-Bankruptcy Code law and legislative history concludes that a secured creditor can not be "adequately protected" for delay damage.[5] The majority's limitation on the "value of the entity's interest in the debtor's property" thus subverts the basic goal of secured transactions and fails to construe § 361 to minimize interference with state-law rights of the secured creditor, as required by *Butner*.

Contrary to the majority opinion, the Ninth Circuit has held that the expansive phrase "the value of an entity's interest in such property" demonstrates a "general intention to protect a broad range of secured creditors' interests." *American Mariner*, 734 F.2d at 430. The secured creditor's right to take possession of and sell the collateral and his right to reinvest the proceeds of sale are valuable rights included in this phrase. 734 F.2d 430-31. Indeed, the House Report accompanying passage of the Bankruptcy Code emphasized the breadth of adequate protection:

> It is not intended to be confined strictly to the constitutional protection required, however. The section and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of

---

[5] Paradoxically, this conclusion means that § 361 of the Bankruptcy Code, which was intended to protect the secured creditor, instead coerces him by allowing the clock to run against his uncompensated opportunity cost.

> the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be imposible or seriously detrimental to the bankruptcy law. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor may not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

H.R. Rep. No. 595 at 339, 1978 U.S. Code Cong. & Ad. News at 5787, 6295.

Further support for interpreting the value of a secured creditor's interest to include the cost of delay in realizing upon its collateral derives from the term "indubitable equivalent" in § 361(3). This is a term of art, understood since Judge Learned Hand's opinion in *In Re: Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935), to require compensation of the secured creditor for the time-value of its rights in collateral. Judge Hand explained adequate protection as follows:

> In construing so vague a grant, we are to remember not only the underlying purposes of the section, but the constitutional limitations to which it must conform. It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most *indubitable equivalence*. (emphasis added)

75 F.2d 942. The opinion went on to require that the secured creditor be paid interest on the value of its collateral following confirmation of a plan of reorganization. "Indubitable equivalent" also appears in 11 U.S.C. § 1129 (b)(2)(A)(iii), where it specifically complements a present-value component to a secured creditor's rights in the event a plan is "crammed down" over his objection. In this section, *Murel Holding* is codified.

The majority do not deny Judge Hand's meaning when he used the phrase, or the significance that his meaning may hold for construing § 361(3). The majority acknowledge the plausibility of the statutory construction reached in *American Mariner* and numerous cases following it. See *In re Deeter*, 53 B.R. 623, 626 (Bankr. N.D. Ind. 1985). Despite these concessions, the majority overcome the "plain meaning" of the statute by concluding that they "do not place significant weight on the action of the conferees when they added the phrase 'indubitable equivalent' to § 361." One may agree with the majority that the legislative history does not explain *why* "indubitable equivalent" was introduced into § 361(3). *But see* majority opinion fn. 28, acknowledging that Congress had the idea of compensation for time-delay before it. After considerable speculation concerning what may or may not have happened in Congress, the majority arrives at its ultimate proposition: that Congress was *unaware* of the origin and meaning of "indubitable equivalent." In light of the specific Congressional approval of Judge Hand's concept of adequate protection in § 1129(b)(2)(A) this seems most unlikely; and curious effect of the majority's legislative analysis is to religate the effect of "indubitable equivalent" to that of a mere precatory expression in

§ 361(3), while according it full scope in § 1129(b)(2)(A). A sounder and more logical view would be to interpret the phrase to require recognition of compensation for delay in both sections of the statute. Consistency in the meaning of language in a statute—and most certainly that of words of art—is not only a virtue, it is a hallmark of faithful statutory construction.

The majority, in sum, have construed the plain meaning of the statute by ignoring significant portions of its express language and by relying instead on what was not said in Congressional hearings.

The majority's method of statutory construction by omission reappears in the *en banc* supplement to the majority opinion concerning the Family Farmer Act.[6] The majority fail to note that Congress there was able to find the words needed to limit adequate protection to the value of the secured creditor's collateral. Certainly, the Family Farmer Act hearings in Congress evoked testimony from witnesses who disliked the perceived impact of *American Mariner* adequate protection requirements upon farmers, and Congress considered this in amending Title 11. Contrary to the implication of the majority, however, that "virtually all" of the witnesses "excoriated" *American Mariner*, half of the witnesses, including a bankruptcy judge and the representative of the prestigious National Bankruptcy Conference, did not seek any statutory rejection of *American Mariner*, and at most, some of them advocated only a mitigation of its perceived effects.

---

[6] It is necessary to discuss the Family Farmer Act because the majority dwelt on its significance at length in their supplemental opinion. Our purpose is to show that signals emanating from the Family Farmer Act, although problematic, reflect in favor of the position espoused by this dissent." . . . [W]hile the views of subsequent Congresses cannot override the unmistakable intent of the enacting one . . . , such views are entitled to significant weight . . . and particularly so when the intent of the enacting Congress is obscure." *Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572, 596, 100 S. Ct. 800, 814, 63 L.Ed.2d 36 (1980).

The Family Farmer Act itself proves that Congress did not reject a secured creditor's right to receive adequate protection of lost opportunity cost.[7] Congress removed the "indubitable equivalent" test and nominally confined adequate protection in family farmer cases to the value of the collateral. However, it substituted a provision, 11 U.S.C. § 1205(3), allowing payment of "reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property . . ." Provision of adequate protection by rent rather than "opportunity cost" payments to secured creditors, to the extent these concepts actually differ, squarely recognizes the secured creditor's entitlement to compensation for delay during bankruptcy. Rent is the quintessential measure of the time-value of real property. According to the majority, "this gives the bankruptcy judge the flexibility to award some compensation to the secured creditor. . . ." Indeed it does. Poignantly, farmers in the Fifth Circuit will henceforth bear a higher adequate protection burden under this "relief" provision

---

[7] The majority would limit the significance of this bill where it conflicts with their position by contending that Congress addressed only a limited problem—relief for bankrupt farmers—and for this reason did not do away with *American Mariner* wholesale. It is worthwhile to point out, however, that Congress, as part of the Family Farmer Act, also amended the Bankruptcy Code to prevent discharge of administrative support judgments and remedy a problem existing in general bankruptcy law. 11 U.S.C. § 523(a)(5) amended by P.L. 99-554 § 281. Congressional vision thus extended beyond the plight of farmers, but did not reach out to repeal *American Mariner*.

of the Family Farmer Act than will non-farm debtors. Congress could not have intended this cruel paradox.[8]

As an adjunct to rejecting the meaning of § 361 endorsed by *American Mariner* and two other circuit courts, the majority cite the alleged inconsistency between payments of "interest" as *American Mariner* adequate protection and allowance of "interest" on claims pursuant to §§ 502(b)(2) and 506(b). This dichotomy is fundamentally flawed and diverts attention from the broad scheme of the Bankruptcy Code, which is fully consistent with providing compensation for lost opportunity costs as an administrative expense. The "interest provisions" set forth two general principles. First, no claim by a secured or unsecured creditor against the debtor's estate is ordinarily allowed for interest "unmatured" at the date of the bankruptcy filing. 11 U.S.C. § 502(b)(2). Accounting for the claims owed by the debtor at the date of bankruptcy thus avoids the complexity of frequent and uneven calculations of post-petition interest. Second, § 506(a) divides the secured claim into a secured portion, based on the value of the creditor's collateral, and an unsecured portion which is treated like any other general unsecured claim. Section 506(b), itself an exception to § 502(b)(2), allows claims by oversecured creditors to include accrued interest at the contract rate, as well as attorneys' fees and other costs provided by the agreement with the debtor.

---

[8] That Congress, while enacting special treatment in bankruptcy for farmers, inferentially approved the *American Mariner* concept of adequate protection for other debtors is supported by legislators' comments at the passage of the Family Farmer Act. Cong. Rec. 15074-15092, Oct. 3, 1986. Senator DeConcini referred to "revision of long held doctrines of the bankruptcy code such as . . . adequate protection." Id. at 15092. Concern was expressed by Senators Thurmond and DeConcini that Congress may have tilted too far from prior concepts of adequate protection and the absolute priority rule in its efforts to assist farmers. Senator DeConcini questioned whether the farm credit system could stand the massive write-downs of debt portended by this "extraordinary," "experimental" legislation. The temporary nature of the program (seven years) was emphasized. This Court does not enjoy the luxury of devising a temporary exception to its construction of the adequate protection provision in § 361.

These "interest" provisions must be viewed in the context of the purpose of § 502 as a whole. Section 502, as qualified by §§ 506(a) and (b), defines on a balance-sheet basis the claims against the debtor for purposes of making payments to creditors whenever a plan or liquidation is accomplished, if there is any dividend. Section 502 also constitutes a balance-sheet for other purposes, purposes such as classifying creditors [§ 1123(a)(1)], determining the amount of claims for voting purposes [§ 1126(c)], disclosing particular payments made pursuant to a plan [§ 1129(a)(4)], and enabling a determination of the feasibility of a plan [§ 1129(a)(11)]. The § 502(b) "interest" provision, like the other balance-sheet functions of § 502, is subject to qualification as necessary to accomplish certain goals within the Bankruptcy Code. The treatment of oversecured creditors under § 506(b) has been noted. Additionally, § 726(a)(5) entitles unsecured creditors to payment of post-petition interest before the debtor may receive anything. If the majority's contention that § 502(b) bars post-petition interest for undersecured creditors is correct, then undersecured creditors are inexplicably and irrationally denied the protection conferred on unsecured creditors by § 726(a)(5). In a major exception to § 502(b)(2), § 1124 specifically permits reinstatement of a debt according to its original contract terms if the debtor brings current the payments of principal and interest accrued during bankruptcy. Section 502(b)(2) is not so seamless a web, excluding all payments of "interest", as the majority suggests.

Moreover, Section 506(b) should be viewed not as an inferential limit on the treatment afforded secured creditors, but as a baseline guarantee of the rights of the oversecured creditor. By this reckoning, the oversecured creditor maintains a safe harbor in § 506(b) and need not even seek adequate protection in court. Allowance of his full contract claim against the debtor is assurred. Of course, if the bankruptcy, by delay or otherwise, threatens the security of this creditor, he may seek relief under § 361. To say that the undersecured creditor lacks the definitive safe harbor is not to conclude that he receives no protection at all. The extent of the undersecured creditor's right to adequate protection must be decided by the court, however, and it differs from his contract rights with the debtor. Section 506(b) therefore constitutes an alternative to, rather than a limitation upon, the secured creditor's right to adequate protection. See Amicus Brief of Prof. Thomas H. Jackson at 26-28.

To suggest adequate protection for lost opportunity cost conflicts with the "interest" provisions proves too much; so, in theory, do adequate protection payments to secured creditors under § 361 for depreciation, for maintaining the taxes and insurance payments on property, and for paying senior debt in order to protect a junior lienholder. In each case, payments are being made on behalf of the secured creditor during bankruptcy *apart from* and in addition to his right to file a claim for principal and accrued interest at the date of bankruptcy. Yet the majority do not quarrel with these other extracontractural payments. The "interest provisions" are not themselves fully consistent with the majority's position. Under § 506(a), a secured creditor's claim may be valued at different times during the bankruptcy for different purposes under the Code [e.g., § 502 allowance of claim, § 364 borrowing, §§ 362 or 363 adequate protection, § 1129(b) cramdown]. A secured creditor could obtain a valuation early in the case that would entitle him to receive adequate protection for depreciation of the collateral and later, under § 506(b), be found "oversecured" so as to demand full contract interest. This may present an unusual case, but it is clearly allowed by the Bankruptcy Code and is no more incongruous than reconciling opportunity-cost adequate protection with the "interest provisions."

The fact is that adequate protection payments of any sort are different from the restrictions created by the "interest provisions." The Bankruptcy Appellate Panel, which ruled against *American Mariner's* secured creditor before that case reached the Ninth Circuit, stated, "we do not agree with the court below that there is a negative implication to be derived from § 506(b) which is applicable to § 361." 27 B.R. 1004, 1009 (1983). First, "unmatured interest" proscribed by § 502 or allowed under § 506(b) accrues at the contract rate on the entire amount owed by the debtor. Adequate protection, however, is based on a § 506(a) valuation of the collateral only, whether for depreciation or for lost opportunity cost purposes. Second, the market rate of interest rather than the contract rate governs adequate protection payments made pursuant to *American Mariner*. *See Fortgang and Mayer, Valuation in Bankruptcy*, 32 UCLA L.Rev. 1061, 1088 (1985). Third, opportunity-cost adequate protection compensates only for the delay caused by *bankruptcy*. Payments of this sort would not ordinarily commence at the filing of a bankruptcy petition, but only following the date when the secured creditor, absent bankruptcy, could have foreclosed upon his collateral. *American Mariner*, 734 F.2d at 435 n. 12.

Fourth, in contradistinction to contract interest, adequate protection for lost opportunity cost need not comprise cash payments at all. *American Mariner* emphasized that payments to the secured creditor are "by no means the only method" of providing adequate protection, 734 F.2d 435, as § 361 explicitly states. For instance, if the debtor owned an office building or real estate development in the process of completion at the date of bankruptcy, and if he offered to complete construction or to embark on an ambitious sales or leasing program as adequate protection for the secured creditor, these activities might suffice and supplant the need for any adequate protection payments for lost opportunity cost. The majority focus on cash payments to exaggerate the perceived conflict between *American Mariner* and the "interest provisions."[9]

---

[9] The majority suggest that "logical inconsistencies have erupted in lower court decisions" concerning the timing and interest rate applicable to *American Mariner* payments, as an argument against the validity of the decision. Section 361's adequate protection requirements across the board have been the most heavily litigated section of the Bankruptcy Code. That stems from their generality, from their being based on difficult and easily variable valuations of property, and from their overriding importance to the protection of secured creditors. The valuation of lost opportunity cost is a fact-specific finding, dependent upon the valuation of collateral in issue, assessing the consequences under state law if the lender were to institute foreclosure, and the applicable interest rate. *See also Fortgang & Mayer, 1986 Interest & Costs for the Secured Creditor in Bankruptcy*, article presented at 1986 NYU Bankruptcy Law Seminar.

Compensating the secured creditor for its lost opportunity cost due to bankruptcy delay is consistent with the treatment of all other "administrative" costs of the bankruptcy proceeding. The costs of doing business as a debtor are paid currently and in full during the proceeding, and, whether they are incurred for attorneys and accountants, for the purchase of goods, or for payment of a post-petition tort claim, are borne by the debtor and its unsecured creditors. 11 U.S.C. §§ 328, 330, 503(b), 507(a)(1), 726. The majority has mistakenly suggested that "all creditors generally share some of the risk": section 506(c), however, allows the estate to recover from a secured creditor *only* the necessary costs and expenses of preserving or disposing of the collateral. Additionally, the Bankruptcy Code is permeated by requirements of special administrative payments during a case to special varieties of creditors. A lessor is entitled to have *all prepetition defaults cured* within a short period after bankruptcy before he need suffer the continued tenancy of a bankrupt. 11 U.S.C. § 365(b). Any party to an "executory contract," such as long-term supply contract or an oil and gas operating agreement, may similarly obtain from the debtor full performance plus additional "assurance" as the *quid pro quo* for continued dealings. *Id.* Section 1110 allows repossession of aircraft or vessels subject to certain financing arrangements if, within 60 days of the filing, all defaults are not cured. The obligations covered by these provisions are funded by the debtor and its unsecured creditors.

An undersecured creditor, no less than a lessor, has property at risk during the reorganization. He is "doing business" with the debtor by virtue of a forced loan

of his collateral. *American Mariner* recognizes, as do the majority, that the true cost of the secured creditor's forced loan includes the time-value of delay in foreclosing. *American Mariner* draws an implicit and reasonable analogy between the rights of a secured creditor under §§ 361(1) and (3) and post-petition "administrative rent," which the debtor must continue to pay currently after seeking protection in bankruptcy. 11 U.S.C. § 503 (b). "Administrative rent" typically includes both projected depreciation of the leased property plus a return on the lessor's investment and thus recognizes the potential income from alternative uses. *2 Collier on Bankruptcy* ¶365.03 (15th Ed. 1986). The Family Farmer Act, as previously noted, has codified this analogy.

Under the foregoing analysis, the only "inconsistency" between administrative payments of any kind during bankruptcy and the § 502 scheme for allowance of claims lies in Congress's decision to require the debtor, as his cost of taking advantage of bankruptcy's automatic stay and opportunity for discharge of debt, to pay his post-petition expenses and certain other obligations currently. Treating as an administrative expense the adequate protection of the secured creditor's "interest in the debtor's property," including lost opportunity cost, is a wholly different matter from the § 502(b)(2) balance-sheet disallowance of claims for unmatured interest on the contract.[10]

---

[10] The majority argue at length that adequate protection cannot include payments for lost opportunity cost because that principle leads to "logical inconsistencies" connected with the confirmation of plans of reorganization. The existence of such inconsistencies was noted by *Fortgang & Mayer, Valuation in Bankruptcy*, *supra*, cited by the majority. Fortgang & Mayer have subsequently commented on this citation as follows: "Like the authors, whose analysis she

The statutory and legislative history arguments of the majority have been analyzed. Their policy views must also be addressed. Pervasive in the original panel opinion, reinstated by the majority, was the notion that if *American Mariner* is correctly decided, a massive transfer of assets from unsecured creditors to undersecured creditors will result, aborting the reorganization process. This seems to be the basic concern that led the majority to traverse the holdings of three circuit courts and most of the bankruptcy courts in this circuit. The majority's fear is based on a misperception of the nature of most Chapter 11 filings under the Bankruptcy Code. It obscures the peril in which an undersecured creditor is placed by the filing of a Chapter 11 petition and ignores the benefit that his peril confers in the form of a forced loan of his collateral to the debtor. Finally, while conceding that *American Mariner* may provide a vehicle whereby the debtor can remain in reorganization with the cooperation of the secured lender for a period of time, the majority incredibly suggest that such an outcome could prejudice the unsecured creditors.

The majority have assumed that all or most Chapter 11 reorganizations have a right to life which is endangered by the prospect of payment of adequate protection for the secured creditor's lost opportunity cost. The sad fact is, on the contrary, that the vast bulk of reorganizations culminate in liquidation by a plan, conversion to Chapter 7, or withering away during the bankruptcy proceedings. Over the last five years, the Administrative Office of the United States Courts reports that 90% of Chapter 11 cases nationwide failed to terminate within the provisions of Chapter 11. Of those in which plans are confirmed, the experienced bankruptcy practitioner knows that many plans call for liquidation of the debtor's assets. Thus, the concern that *American Mariner* adequate protection frustrates the "reorganization policy" of bankruptcy law is irrelevant to the 90% of cases which ultimately liquidate. Compare *Jackson, Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Non-Bankruptcy Rules,* 60 Am. Bankr. L. J. 399, 416 (1986).

The actual impact of *American Mariner* in unreorganizable cases should be favorable for secured and unsecured creditors alike. A hapless Chapter 11 effort may be kept aloft, absent *American Mariner,* for *years,* given moderately astute debtor's counsel, a court too busy or too docile to terminate the case, and a steady cash flow. The debtor survives in the meantime by consuming its assets, including any going-concern surplus that may have originally existed in the company, by suffering piecemeal foreclosures or, in some cases, by siphoning off cash and assets illegally. To the extent that a secured creditor is entitled to adequate protection to compensate for the opportunity cost of delaying foreclosure, his right takes the profit out of the debtor's standard tactic of delay. If the debtor is thus forced to close down sooner than it otherwise would have, some

---

cited, Judge Randall found difficulty in reconciling ***American Mariner*** interest with various sections of the Code. . . . Unlike the authors, whose contrary conclusion she did ***not*** cite, Judge Randall found such difficulty reason to reject ***American Mariner.***" ***Fortgang & Mayer, 1986 Interest and Costs for the Secured Creditor in Bankruptcy,*** paper prepared for NYU bankruptcy law seminar. In any event, the reconciling of ***American Mariner*** payments with confirmation provisions of the Code is a highly speculative, hypothetical, and complex enterprise, which is not presented by the facts of this case and should not be here decided. Messrs. Fortgang and Mayer have admirably explored the necessary reconcilations in their two articles.

equity may remain for the unsecured creditors and they will be paid sooner. The administrative carrying costs of bankruptcy, including attorneys' and other professionals' fees, are reduced in this situation, where they would ultimately have been spent for naught. Shortening the bankruptcy proceeding by the threat of an award of *American Mariner* adequate protection (since in this type of case it is unlikely that any payments would ever be made) cannot possibly favor the interest of secured creditors over unsecured creditors. Both classes share its benefits. Moreover, there is a social gain from rendering bankruptcy more expeditious and facilitating the transfer of assets from nonproductive to productive ventures.

This case exemplifies the horde of hopeless bankruptcy cases in which the national reorganization policy is irrelevant. A one-asset limited partnership, Timbers has no full-time employees and no business except the rental of one unit of apartments. Its major unsecured debt is owed to the insider management company, while the rest of the unsecured debt totals $17,000. United Savings is the only secured creditor. Award of adequate protection based on lost opportunity cost does not thwart the debtor's right to reorganize if there was nothing to reorganize in the first place.[11]

This Court unanimously endorses tighter supervision of bankruptcy cases such as this by both the lower courts and interested parties to limit patent abuses of Chapter

---

[11] As the Family Farmer Act in part demonstrates, not every single-asset bankruptcy case is filed in bad faith. Timbers, however, shares a predicament with many single-asset cases which may be vulnerable to dismissal or lifting the automatic stay on the ground that bankruptcy was filed in bad faith. *See In Re: Little Creek Development*, 779 F.2d 1068 (5th Cir. 1968).

11. Consequently, the majority's extended discussion of creditor remedies available under the Bankruptcy Code is helpful, if somewhat pallid compared with the overriding concern for the debtor and "reorganization policy" expressed in the original panel opinion. The trouble with creditors' remedies (e.g., lifting the automatic stay because the property is not necessary to an effective reorganization [§ 362(d)(2)], seeking conversion to Chapter 7 or appointment of a trustee [§ 1112], and limiting the debtor's exclusivity period [§ 1121]) is that in practice, as shown by the case statistics, they have not been enforced. Thus, the majority's exhortation that bankruptcy courts be "sensitive" to creditors' rights under the Bankruptcy Code is an unsatisfactory substitute for enforcing the statutory requirement that adequate protection include compensation for a secured creditor's lost opportunity cost.

What will be the effect of adequate protection for lost opportunity cost in the few cases that have a realistic chance to reorganize? I believe that, contrary to the panel's opinion, *American Mariner* motivates all parties to the case to reach a prompt agreement to a plan. At the very least, it will galvanize the debtor, who is always the key figure in arriving at a successful plan. The objective candidate for a successful Chapter 11 reorganization is not hard to describe: it has some cash and a decent cash flow, encumbered or not; it has at least *some* lines of business that are profitable or nearly so; it has good management; and it is not facing a disastrous economic forecast in all of its markets. Given those conditions, if a court awards adequate protection recognizing the secured creditor's cost of delaying foreclosure, the debtor will not usually collapse, because it can afford some level of such protection; but it will propose a plan. Aside from debtor procrastination, the most significant source of delay in the potentially successful cases is bickering among creditor groups. *American Mariner* forces creditor groups to focus their attention rapidly on a potentially dwindling pie. Even if the panel is correct in its assertion that a secured creditor receiving adequate protection payments for lost opportunity cost would be disinclined to negotiate (a conclusion I do not share), the cram-down provision of the Bankruptcy Code § 1129(b), takes the matter of delay out of the secured creditor's hands and always creates settlement incentive.

Two other points should be made about *American Mariner's* impact on the reorganizable company. First, in such a case, the majority's fear that payments to secured creditors will swamp the ship within a few weeks or months of the bankruptcy filing is misplaced. Both *American Mariner* and *Grundy*, the Fourth Circuit case, delay imposing opportunity-cost adequate protection in accord with the time ordinarily needed to effect a foreclosure and sale under state law. The court below triggered payments in six months from its ruling. An automatic breathing space results for the debtor. Second, the panel's concern that *American Mariner* subverts the reorganization process by transferring the cost from secured to unsecured creditors depends upon one's point of view. If the effect of *American Mariner* in the reorganizable case is to speed up the proceedings, this fact alone should benefit unsecured creditors by reducing the transaction costs of the bankruptcy. Also, to the extent that adequate protection for lost opportunity cost is taken into account in the formulation of a plan, reducing the principal on outstanding debt, encouraging the secured creditor to modify his

security or to cooperate in stretching out payments after bankruptcy, the debtor's and unsecured creditors' prospects are ultimately improved.

Providing adequate protection to the secured creditor for his lost opportunity cost occasioned by bankruptcy is not the foe of the reorganization process. I can do no better than to summarize the position of the dissent than to quote from *American Mariner*:

> The secured creditor's right to take possession of and sell collateral on the debtor's default has substantial, measurable value. The secured creditor bargains for this right when it agrees to extend credit to the debtor and both parties consider the right part of the creditor's bargain. The right constitutes an "interest in property" that is "created and defined by state law," and we are aware of no federal interest that requires this right of the secured creditor to go unprotected "simply because an interested party is involved in a bankruptcy proceeding." *See Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 917-918, 59 L.Ed.2d 136 (1979). The Court in *Butner* observed that "[u]niform treatment of property interests by both state and federal courts within a State serves . . . to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'" 440 U.S. at 55, 99 S. Ct. at 918 (quoting *Lewis v. Manufacturers National Bank*, 364 U.S. 603, 609, 81 S. Ct. 347, 350, 5 L.Ed.2d 323 (1961)). To the extent that the debtor in bankruptcy can prevent the secured creditor from enforcing its rights against collateral while the debtor benefits from the creditor's money, the debtor and his unsecured creditors receive a windfall at the expense of the secured creditor.

We conclude that sections 361 and 362(d) were drafted to preclude such a windfall and to insure that the secured creditor receives the benefit of its bargain. We are satisfied that our holding in this case will not inhibit successful reorganization, but rather will promote among other things the ready availability of affordable credit.

I respectfully DISSENT.

APPENDIX B

In re TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD., Debtor.

UNITED SAVINGS ASSOCIATION OF
TEXAS, Movant-Appellee
Cross-Appellant,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Respondent-Appellant
Cross-Appellee.

No. 85-2678.

United States Court of Appeals,
Fifth Circuit.

July 9, 1986.

Secured creditors moved for relief from automatic stay or for adequate protection. The Bankruptcy Court, Wesley W. Steen, J., sitting by temporary assignment, 49 B.R. 454, required debtor to pay $7,956 monthly to taxes and interest escrow, and $42,500 monthly for adequate protection of foreclosure rights, and appeal was taken. The United States District Court for the Southern District of Texas, James DeAnda, J., affirmed, and appeal was taken. The Court of Appeals, Randall, Circuit Judge, held that Congress did not intend to provide undersecured creditors with periodic postpetition interest payments on value of their collateral as element of adequate protection.

Reversed and remanded.

Leonard H. Simon, Daphne L. Levey, Tim Henderson, Houston, Tex., for respondent-appellant cross-appellee.

H. Miles Cohn, Houston, Tex., for movant-appellee cross-appellant.

Appeals from the United States District Court for the Southern District of Texas.

Before GOLDBERG, RANDALL and JOHNSON, Circuit Judges.

RANDALL, Circuit Judge:

[1] In a proceeding under the federal bankruptcy laws, an oversecured creditor (a secured creditor whose collateral is worth more than the amount of its debt) is entitled to receive at the conclusion of the proceeding interest on the debt accrued during the proceeding as a part of its allowed claim. By contrast, neither an undersecured creditor (one whose collateral is worth less than the amount of its debt) nor an unsecured creditor is entitled to receive such interest as part of its allowed claim. This case presents the question whether Congress in 1978, in codifying the principles which had developed under the common law to ensure that a secured creditor's interest in the value of its collateral would be adequately protected during the pendency of a reorganization proceeding, intended that an undersecured creditor would be entitled to receive during the proceeding periodic cash interest payments on the value of the collateral, even though a claim for interest on the debt would not be allowed at the conclusion of the proceeding. The Ninth and Fourth Circuits hold that an undersecured creditor is entitled as a matter of law to periodic interest payments during the proceeding. *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984); *Grundy National Bank v. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985). The Eighth Circuit holds that an undersecured creditor is not entitled to such payments as a matter of law, but may be so entitled depending on the circumstances. *In re Briggs Transportation Co.*, 780 F.2d 1339 (8th Cir. 1985).

[2] While recognizing the cogent arguments that have been adduced in support of both such positions, we are not persuaded that Congress intended in 1978 to make fundamental changes in the adequate protection rules as they had developed before 1978, or to alter, through adequate protection provisions, the settled rules regarding the accrual and payment of interest during the pendency of a bankruptcy proceeding. Further, a rule requiring periodic postpetition interest payments to undersecured creditors would often have a substantial adverse impact on the orderly procedures for the distribution of a debtor's estate upon liquidation or reorganization; would frequently result in a premature reallocation of the unencumbered assets of an estate from unsecured to undersecured creditors; and would materially alter the rule that all creditors generally share some of the risk in a reorganization proceeding that a successful reorganization will not be feasible. We think it unlikely that Congress would have adopted such a rule—entailing, as it does, major changes in the way in which a reorganization proceeding is conducted—without clear, unequivocal statements to that effect in the bankruptcy statute or, at least, in its legislative history. No such statements appear. To the contrary, the statute and its legislative history strongly suggest, and we hold, that Congress did not intend to provide undersecured creditors with periodic postpetition interest pay-

ments on the value of their collateral as an element of adequate protection.

I.

Debtor Timbers of Inwood Forest Associates, Ltd. ("Timbers") appeals from an order of the United States District Court for the Southern District of Texas affirming the decision of the Bankruptcy Court ordering payment to United Savings Association of Texas ("United") of cash amounts representing lost "opportunity costs" on the amount of United's secured claim. "Opportunity costs," according to United, are the funds it would earn if it were allowed to foreclose its lien, sell the collateral and reinvest the proceeds.[1] United cross-appeals, assert-

---

[1] Several commentators and courts seem to believe that by calling these proposed payments compensation for "lost opportunity," they need not consider how to reconcile the payments with the interest provisions of the Bankruptcy Code of 1978, 11 U.S.C. §§ 502(b)(2), 506(b). However, "opportunity cost payments" are simply postpetition interest payments in sheep's clothing—"compensation allowed by law or fixed by the parties for the use or forbearance or detention of money," *Black's Law Dictionary* 729 (5th ed. 1979)—albeit on the value of the collateral rather than on the principal amount of the debt as called for by the contract. The first commentator to advance the notion, Patrick A. Murphy, expressly made the connection between these payments and interest: "If the interim cash payments alternative [of the adequate protection provision, 11 U.S.C. § 361] is used, perhaps the secured creditor should receive interest or compensation for its cost of funds." Murphy, *Use of Collateral in Business Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 Calif. L. Rev. 1483, 1506 (1975). *See also Yamaha Motor Corp., U.S.A. v. Shadco*, 762 F.2d 668, 670 (8th Cir. 1985) (creditor "claims that it is entitled to post-petition interest on its claim as an element of 'adequate protection'"); *In re Briggs Transportation Co.*, 780 F.2d 1339, 1340 (8th Cir. 1985); *In re Pulliam*, 54 B.R. 624, 625-26 (W.D. Mo. 1985); *In re Deeter*, 53 B.R. 623, 629 (Bankr. N.D. Ind. 1985) (payments for lost opportunity costs are "interest payments"); *In re Vanas*, 50 B.R. 988, 993 (Bankr. E.D. Mich. 1985) (creditor "contends that it is entitled to interest payments and ade-

ing that the formula adopted by the Bankruptcy Court for determining the amount of payments is incorrect.

The underlying facts are not complicated. Timbers is a limited partnership that owns a 188-unit apartment complex in northwest Houston. United holds a ten-year note executed by Timbers in June 1982, in the original principal amount of $4,100,000 secured by a deed of trust on the apartment complex and an assignment of rents. Monthly payments for the first three years of the

---

quate protection for the delay in enforcing its right of foreclosure caused by the automatic stay"); *In re Shriver*, 33 B.R. 176, 185 (Bankr. N.D. Ohio 1983) (opportunity cost payment "permits the undersecured creditor to be paid interest and at the market rate not the contract rate"); *In re Monroe Park*, 17 B.R. 934, 940 (D. Del. 1982) (undersecured creditor entitled to "periodic cash payments . . . as compensation for the accruing interest charges"); *In re B & W Tractor Co.*, 38 B.R. 613, 617 (Bankr. E.D. N.C. 1984) (opportunity cost payments are postpetition interest payments); *In re Alexander*, 48 B.R. 110, 113 (Bankr. W.D. Mo. 1985) (secured creditor should receive interest for delay in enforcing its rights), *cf. In re Nesmith*, 57 B.R. 348, 394 (Bankr. E.D. Pa. 1986) (interpreting *American Mariner* to hold that "the size of a secured lender's debt . . . includes interest on arrearages for purposes of deciding motion on relief from the automatic stay").

Indeed, although the court in the leading case awarding such payments carefully avoided calling them interest payments, *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984), counsel for the secured creditor in that case framed the issue on appeal as whether "an undercollateralized secured creditor is entitled to post-petition interest upon the value of its collateral as a condition of denying relief from the automatic stay?" *In re American Mariner Industries, Inc.*, 27 B.R. 1004, 1005 (Bankr. App. 9th Cir. 1983), *rev'd*, 734 F.2d 426 (9th Cir. 1984). Murphy interprets *American Mariner* to hold that "an undersecured creditor is entitled to *interest* on the secured claim." Murphy, *Litigating Stays and Adequate Protection*, in *Secured Creditors and Lessors Under the Bankruptcy Reform Act* 38 (PLI 1985) (emphasis added). *See generally* Epstein & Fuller, *Chapters 11 and 13 of the Bankruptcy Code—Observations on Using Case Authority from One of the Chapters in Proceedings Under the Other*, 38 Vand. L. Rev. 901, 914 (1985) (noting difficulty in distinguishing "opportunity costs" from postpetition interest).

note were to be $45,842.06, including an interest rate of fourteen percent, plus $7,956 monthly escrow for taxes and insurance. No payment has been made on the note since August 1984. United noticed a foreclosure on the Timbers property at some point, but on March 4, 1985, Timbers filed a petition under Chapter 11 of the Bankruptcy Code of 1978 ("Code" or "Bankruptcy Code"), 11 U.S.C. §§ 101-1330, automatically staying the foreclosure. United and Timbers entered into an agreed order that required Timbers to pay United the net income produced by the apartments.

On March 18, 1985, United moved in the Bankruptcy Court for relief from the automatic stay under § 362(d)(1)[2] "for cause, including the failure [by Timbers] to provide adequate protection of [United's] security interest." The Bankruptcy Court held an evidentiary hearing on the motion. Evidence introduced at the hearing indicates that on April 16, 1984, the principal balance of the note was $3,929,319.28 and unpaid accrued interest amounted to $437,069.49, for a total of $4,366,388.77. Expert testimony introduced by Timbers fixed the "fair market value" of the property at $4,250,000, while United's expert placed its fair market value at $3,614,000 to $4,230,000. Timbers' expert also testified that the "liquidation value" of the property was $2,650,000. Both experts agreed that the property value would appreciate to a modest extent, but United was at the time of the hearing, and for the purpose of this appeal

remains, an undersecured creditor. There was no evidence that future appreciation would be able to provide security for interest accruing postpetition under the terms of the note. Neither party presented evidence on the likelihood of successful reorganization.

United argued at the hearing that absent the automatic stay, it would foreclose on and sell the property and reinvest the proceeds at the market rate. It argued that because Timbers had not provided it with "adequate protection" of its "interest" in the present value of the proceeds, the stay should be dissolved. The Bankruptcy Court, in a detailed opinion, agreed in large part with United, and on April 24, 1985, ordered monthly payments of $50,456: $7,956 for the escrow, to commence immediately, and $42,500 for United's "lost opportunity cost" to commence on September 4, 1985, based on a value on foreclosure of $4,250,000 and a 12% interest rate. 49 B.R. 454 (Bankr. S.D. Tex. 1985). The lost opportunity payments are in an amount only slightly less than the monthly principal and interest payment due under the note—$45,842.06. The court ordered that the lost opportunity payments "may be made from rental receipts otherwise subject to the agreed cash collateral order herein," but did not limit Timbers' obligation to the amount of the net rental income. The Bankruptcy Court relied in large part on the Ninth Circuit's decision in *American Mariner*. On appeal, the District Court affirmed.

II.

Many commentators and courts view the issue before us as one of policy and economics. One side opines that the failure to award postpetition interest payments will restrict the availability of secured credit to the detriment of businesses that cannot obtain credit otherwise. The other concentrates on the deleterious effects that post-petition interest payments will have on the possibility of reorganizations. It seems that the debate has become not what the Bankruptcy Code requires, but what it should require. If we were Members of Congress, or if bankruptcy law were not controlled by a statute, we might find the economic debate of primary significance. However, as judges, we must be governed by congressional intent as set forth in the Bankruptcy Code. "The relevant question is not whether, as an abstract matter, the rule advocated . . . accords with good policy. The question we must consider is whether the policy [advocated] is that which Congress effectuated by its enactment of" the statute at issue. *Badaracco v. Commissioner*, 464 U.S. 386, 398, 100 S. Ct. 756, 764, 78 L.Ed.2d 549 (1984). "Courts are not authorized to rewrite a statute because they might deem its effects susceptible of improvement." *Id.*

---

[2] (d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest. . . .

The issue we face is simply one of statutory interpretation: Does "adequate protection" under § 362(d)(1) contemplate that an undersecured creditor will receive post-petition interest periodically in cash or some other form to compensate it for "lost opportunity" when its right to foreclose is temporarily suspended by the automatic stay. Our role in interpreting statutes is limited:

> While the judicial function in construing legislation is not a mechanical process from which judgment is excluded, it is nevertheless very different from the legislative function. Construction is not legislation and must avoid "that retrospective expansion of meaning which properly deserves the stigma of judicial legislation." *Kirschbaum v. Walling*, 316 U.S. 517, 522 [62 S. Ct. 1116, 1119, 86 L.Ed. 1638]. To blur the distinctive functions of the legislative and the judicial processes is not conducive to responsible legislation.

Addison v. Holly Hill Fruit Products Co., 322 U.S. 607, 618, 64 S. Ct. 1215, 1221, 88 L.Ed. 1488 (1944) (Frankfurter, J.).

The familiar starting point in statutory interpretation is the plain meaning rule: "the meaning of the statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, . . . the sole function of the courts is to enforce it according to its terms." *Caminetti v. United States*, 242 U.S. 470, 485, 37 S. Ct. 192, 61 L.Ed. 442 (1917). In interpreting a statute, it must be recalled that:

> [E]ach part or section [of a statute] should be construed in connection with every other part or section so as to produce a harmonious whole. Thus it is not proper to confine interpretation to the one section to be construed.

2A N. Singer, *Sutherland Statutory Construction* § 46.05, at 90 (rev. 4th ed. 1984 & Supp. 1985).[3]

With these principles in mind, we turn to an examination of the language of the relevant provisions of the Code. In general, a creditor may receive funds from a debtor after a bankruptcy petition is filed during the two distinct periods of the proceeding: at its termination and during its pendency. First, we review the sections that determine the amount of a claim that the court may allow at the termination of the proceeding, when the bulk of the estate's assets historically has been distributed, and whether that claim may include an amount for interest accruing during the proceeding. §§ 502, 506. Second, we examine the provisions requiring adequate protection of a secured creditor's interest in its collateral during the proceeding. §§ 361-362(d)(1), which under certain circumstances may require payments to a secured creditor from the estate before the proceeding is concluded.

---

[3] *See also United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 222, 73 S. Ct. 227, 229, 97 L.Ed. 260 (1952) (various sections of statute "must be read in relation to each other"); *United States v. Boisdore's Heirs*, 49 U.S. (8 How.) 113, 122, 12 L.Ed. 1009 (1850) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.").

A. The Allowed Secured Claim and Interest—§§ 502 and 506.

After a debtor files a bankruptcy petition, a creditor may file a proof of claim against the estate in the amount that it asserts is owed to it by the debtor. The claim is deemed to be "allowed" if no party in interest objects, § 502(a), or if the court after notice and a hearing allows the claim, in the amount owing as of the date that the petition was filed, § 502(b). An allowed claim of a creditor secured by a lien on property of the debtor is an "allowed secured claim" to the extent of the value of that creditor's interest in the property, and is an unsecured claim to the extent that the amount of the allowed secured claim is less than the amount of the allowed claim. § 506(a). The value of the collateral is determined in light of the purpose of the valuation and of the proposed disposition or use of the collateral. § 506 (a). A creditor with an allowed secured claim may receive, upon termination of the proceeding or at such earlier time as may be allowed by the court, either the collateral or the value of the collateral up to the amount of the allowed secured claim. See §§ 506(a), 726(a), 1129. To the extent that an allowed claim is unsecured by a lien on property of the estate, the creditor's allowed claim may be paid out of unencumbered assets of the estate in accordance with the priority schedule set forth in § 507(a). In summary, therefore, an undersecured creditor in effect wears two hats because it has two types of claims at the conclusion of a proceeding: an allowed secured claim in an amount equal to the value of its collateral, and an unsecured claim for any deficiency, which is treated as is any other unsecured claim.[4]

[3] As a general rule, creditors are not allowed a claim for interest accruing on their debts during bankruptcy proceedings. Since the middle of the 18th century, bankruptcy law has provided that interest on debts does not accrue after a bankruptcy petition is filed. *Sexton v. Dreyfus,* 219 U.S. 339, 344, 31 S. Ct. 256, 257, 55 L.Ed. 244 (1911) ("For more than a century and a half the theory of the English bankrupt system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission."). The rule developed "not because of the words of the statute, but as a fundamental principle" of equity. *Id.* The reason for the rule as it developed was as follows:

> Exaction of interest, where the power of a debtor to pay even his contractual obligations is suspended

---

[4] 11 U.S.C. § 1111(b)(2) gives a class of undersecured creditors the option to elect treatment of their claims solely as secured claims. *See generally* Eisenberg, *The Undersecured Creditor in Reorganizations and the Nature of Security,* 38 Vand. L. Rev. 931 (1985).

> by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of *all* interests involved. . . . "[T]he delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate."

Vanston Bondholders Protection Committee v. Green, 329 U.S. 156, 163, 67 S. Ct. 237, 240, 91 L.Ed. 162 (1946) (quoting *Thomas v. Western Car Co.,* 149 U.S. 95, 116-17, 13 S. Ct. 824, 833, 37 L.Ed. 663 (1893)). In other words, allowing the accrual of postpetition interest in favor of one creditor would be "inequitable" to other creditors. *Vanston,* 329 U.S. at 164, 67 S. Ct. at 240; *cf. Ticonic National Bank v. Sprague,* 303 U.S. 406, 411, 58 S. Ct. 612, 614, 82 L.Ed. 926 (1938) ("It is in order to assure equality among creditors as of the date of insolvency that interest accruing thereafter is not considered."). Justice Stewart reiterated this rationale in *Nicholas v. United States,* 384 U.S. 678, 86 S. Ct. 1674, 16 L.Ed.2d 853 (1966):

> We believe that the decisions of this Court in *Sexton* and [*New York v.*] *Saper* [, 336 U.S. 328, 69 S. Ct. 554, 93 L.Ed. 710 (1949),] reflect the broad equitable principle that creditors should not be disadvantaged *vis-a-vis* one another by legal delays attributable solely to the time-consuming procedures inherent in the administration of the bankruptcy laws. In the context of interest-bearing debts, the equitable principle enunciated in *Sexton* and *Saper* rests at bottom on an awareness of the inequity that would result if, through the continuing accumulation of interest in the course of subsequent bankruptcy proceedings, obligations bearing rela-

> tively high rates of interest were permitted to absorb the assets of a bankruptcy estate whose funds were already inadequate to pay the principal of the debts owed by the estate.

384 U.S. at 683-84, 86 S. Ct. at 1679.

The rule barring accrual of postpetition interest on secured debt did not apply in certain situations where the reason for the rule was itself inapplicable. First, an oversecured creditor was entitled, depending on the equities of the situation, to claim postpetition interest, but only to the extent that the principal of the debt plus accrued interest did not exceed the value of the collateral securing the debt and the interest.[5] *Vanston,* 329 U.S. at 164-65, 67 S. Ct. at 240-41; *Sexton,* 219 U.S. at 346, 31 S. Ct. at 258; *Coder v. Arts,* 152 F. 943, 950 (8th Cir. 1907), *aff'd,* 213 U.S. 223, 29 S. Ct. 436, 53 L.Ed. 772 (1909). Further, secured creditors (and unsecured creditors, as well) might be entitled to postpetition interest if the debtor's estate ultimately proved to be solvent. *American Iron & Steel Mfg. Co. v. Seaboard Airline Railway Co.,* 233 U.S. 261, 266, 34 S. Ct. 502, 504, 58 L. Ed. 949 (1914) ("if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid").[6]

---

[5] Put differently, the petition *suspended* the contract right to accrue interest; it did not *extinguish* the right. *Nicholas,* 384 U.S. at 682 n. 9, 86 S. Ct. at 1678-79 n. 9. Therefore, in certain circumstances, such as when a creditor was oversecured, interest continued to accrue. *See* O'Toole, *Adequate Protection and Postpetition Interest in Chapter 11 Proceedings,* 56 Am. Bankr. L.J. 251, 254 (1982).

[6] The rule that disallowed postpetition interest is sometimes not applied where the collateral is itself income producing, e.g., debt or equity securities, and the interest or dividend earned is applied to interest accruing postpetition. *Sexton,* 219 U.S. at 346, 31 S. Ct. at 258; *In re Black Ranches, Inc.,* 362 F.2d 8, 15 (8th Cir.), *cert.*

This rule regarding accrual of postpetition interest arose when the bankruptcy laws did not provide for reorganization and consisted only of a mechanism to liquidate an estate equitably. *See American Iron and Steel Mfg. Co.*, 233 U.S. at 266, 34 S. Ct. at 504. Nevertheless, as the bankruptcy laws developed to provide for reorganizations, the rule was extended to Chapter XI of the Bankruptcy Act of 1898 ("Act") arrangement proceedings so that "the accumulation of interest must be suspended as of the date the Chapter XI petition was filed," *Nicholas*, 384 U.S. at 686, 86 S. Ct. at 1681, and to corporate reorganization proceedings under Chapter X of the Act, id. at 686 n. 14, 86 S. Ct. at 1681 n. 14.[7]

---

denied, 385 U.S. 990, 87 S. Ct. 595, 17 L.Ed.2d 450 (1966). The rationale for this exception is as follows:

> There is no more reason for allowing the bankrupt estate to profit by the delay beyond the date of settlement than there is for letting the creditor do so. Therefore to apply these subsequent dividends, & c., to subsequent interest seems just.

Sexton, 219 U.S. at 346, 31 S. Ct. at 258.

[7] *See generally Georgia, F. & A. R. Co. v. Bankers Trust Co.*, 170 F.2d 733, 734 (5th Cir. 1948); *Oppenheimer v. Oldham*, 178 F.2d 386, 388 (5th Cir. 1949) ("It has always been the rule in bankruptcy administration that the accrual of simple interest on unsecured claims runs only to the date of bankruptcy, and as held by most courts the same has been true of deficiently secured claims," but interest may be permitted "on amply secured claims.").

Congress eventually codified the prevailing rule in substantial part, and the interest provision of the Act in effect at the time the Code was under consideration was as follows:

> Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest.

11 U.S.C. § 103(a)(1) (1976) (repealed 1978).

[4, 5] The Code expressly continued these prevailing rules.[8] Under § 502(b)(2), a claim against an estate will not be allowed to the extent that "such claim is for unmatured interest" as of the date of the filing of the petition. Section 506(b) continues the pre-Code rule applicable to the oversecured creditor:

> (b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.[9]

The Code continues to treat oversecured and undersecured creditors differently as to their entitlement to a claim for postpetition interest at the end of a reorganization proceeding.

In summary, the interest provisions of the Code and its predecessors, as interpreted by the Supreme Court for almost a century, are premised on the equitable principle that the unencumbered assets of a debtor's estate will not be used to benefit one class of creditors at the expense of another class. Such would be the case if unencumbered assets, otherwise available for the payment of unsecured claims, were used to pay postpetition interests on undersecured debt. Allowing a claim for postpetition interest by an oversecured creditor, on the other hand, is not inconsistent with that equitable principle, because only assets encumbered by the creditor's lien will be used to fund the payment of postpetition accrued interest.

---

[8] Postpetition interest rules enacted in 1978 were described in all applicable legislative materials as codifying "current law." S. Rep. No. 989, 95th Cong., 2d Sess. 63, 68 *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5849 (§ 506(b) "codifies current law" by giving "a creditor with an oversecured claim" interest "to the extent that the value of the collateral exceeds the amount of the underlying claim" [hereinafter cited as *Senate Report*]; H.R. Rep. No. 595, 95th Cong., 2d Sess. 356-57, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5963, 6312 [hereinafter cited as *House Report*]. *See also* O'Toole, *supra*, 56 Am. Bankr. L.J. at 267 (Section 506(b) represents codification of *Coder* exception).

[9] Finally, in the rare case of liquidation of a solvent estate, an unsecured creditor may receive postpetition interest on an allowed claim. § 726(a)(4), (5).

B. The Automatic Stay and Adequate Protection Payments—§§ 361 and 362.

Upon the filing of a bankruptcy petition, § 362(a) of the Code imposes an automatic stay on actions by creditors to collect their claims from a debtor. Section 362(a) temporarily bars a creditor from, among other things, foreclosing on a debtor's property to enforce a security interest. The purpose of the automatic stay is to "give[ ] the business a breathing spell and time to work constructively with its creditors" to propose a plan of reorganization, as well as to prevent creditors from "obtaining preferential treatment by quick action." *House Report, supra*, at 174.[10]

[6, 7] Under § 362(d), a creditor may obtain relief from the stay (1) "for cause, including the lack of adequate protection" of the creditor's interest in the collateral, or (2) when a "debtor does not have an equity

---

[10] *See also Senate Report, supra,* at 49 (automatic stay "provides creditor protection," preventing creditors from pursuing their own remedies); J. Trost, G. Treister, L. Forman, K. Klee, R. Levin, *The New Federal Bankruptcy Code* 91 (1979) (automatic stay is "essential in liquidation cases to enable the trustee to preserve the estate and to carry out his administrative duties").

in" the property and "the property is not necessary to an effective reorganization." If a creditor files a complaint seeking relief from the stay under § 362(d), the burden of proof, or the risk of non-persuasion, is on the debtor for all issues except the issue of the debtor's equity in the property, § 362(g). Therefore, in a proceeding arising under § 362(d)(1), the debtor must prove that the secured creditor's interests is adequately protected, or the automatic stay will lift.

The phrase "adequate protection of an interest in property" set forth in § 362(d)(1) is not defined in the Code. However, § 361 lists three ways that "adequate protection may be provided." Under § 361(1), a debtor may be required to make a cash payment or periodic cash payments to a creditor, to the extent that the stay "results in a decrease in the value of" the creditor's interest in the property. This method would seem to be particularly appropriate when collateral is depreciating at a steady rate. Under § 361(2), a creditor may be given a lien on unencumbered property, again to the extent that the stay "results in a decrease in the value of" the creditor's interest in the property. This would appear to protect a secured creditor when a debtor proposes to use cash collateral or may consume other collateral at an uneven rate, such as inventory.

Under § 361(3), a catch-all provision, the court may "grant other relief . . . as will result in the realization by [the creditor] of the indubitable equivalent of" the creditor's interest in the property. A guarantee or bond by a third person not involved in the proceeding might provide such protection. Section 361(3) expressly states, however, that providing a creditor with an administrative priority claim as a form of adequate protection is precluded, although an administrative priority is automatically provided by § 507(b) in the event that the form of adequate protection actually provided by the court ultimately proves to be insufficient.

Clearly neither subsection (1) nor (2) authorizes periodic payments to a creditor whose collateral is not decreasing in value. The issue presented in this case is whether subsection (3) was intended by Congress to permit the periodic payment to an undersecured creditor of postpetition interest on the value of its collateral when that creditor would not have a claim for postpetition interest at the conclusion of the proceeding, or whether Congress simply intended subsection (3) to permit a bankruptcy judge to fashion methods of protection against a decline in value of collateral alternative to those set forth in subsections (1) (cash payments) and (2) (replacement liens).

The origin of the phrase "indubitable equivalent" that appears in § 361(3) arguably provides support for a conclusion that § 361(3) goes beyond protection against a decline in value of the collateral and requires payment of postpetition interest.[11] The phrase first appeared in Judge Learned Hand's leading opinion in *In re Murel Holding Co.*, 75 F.2d 941 (2d Cir. 1935), which held in the context of the proposed confirmation of a plan proposed by a debtor over the dissent of a secured creditor (commonly called a cram-down) that the dissenting se-

---

[11] *See, e.g.*, *In re Deeter*, 53 B.R. 623, 626 (Bankr. N.D. Ind. 1985) ("By using the indubitable equivalent language in § 361, it seems apparent that Congress envisioned compensation for the delay in exercising foreclosure rights as a part of adequate protection."). The meaning of "indubitable equivalent" is "[p]probably the most litigated issue in cases dealing with section 361." W. Norton, 1984 *Annual Survey of Bankruptcy Law* 197.

cured creditor was entitled to the present value of his secured claim in cash or "a substitute of the most indubitable equivalence." *Id.* at 942. The court noted that the usual way the equivalent of a claim is provided following confirmation of a plan of reorganization is by paying the creditor post-confirmation interest on the amount of the claim. By using the "indubitable equivalent" phrase in § 361, Congress conceivably imported the standard for the confirmation of a plan over the dissent of a class of secured creditors into the adequate protection provisions of the Code, requiring protection of the present value of a creditor's secured claim during the stay.

Reliance on the phrase to award postpetition interest payments as protection of a creditor's interest, however, begs the question: "indubitable equivalent" in § 361(3) refers to a substitute for a particular interest; it does not define the interest. Subsections (1) and (2) state that the creditor is protected against a decline in the value of the collateral occasioned by the use, sale or lease of the collateral by the debtor during the stay. Subsection (3) does not state what interest is to be protected during the automatic stay. In the context of the entire section, it is certainly possible that subsection (3) simply gives the court means of providing adequate protection that are alternatives to those set forth in (1) and (2), periodic cash payments and replacement liens, to compensate a creditor for a decline in value of its collateral.[12] If that is the case, subsection (3) does not expand the range of substantive creditor interests protected.

---

[12] The authors of *The New Federal Bankruptcy Code*, *supra*, appear to agree with this interpretation of § 361:

> We are told [by § 361] that "when adequate protection is required" it may be provided by cash payments, 11 U.S.C. § 361 (1), additional collateral, 11 U.S.C. § 361(2), or any other *method* that will give to the secured party "the indubitable equivalent" of what might be lost by the continued use of his collateral.

Id. at 287 (emphasis added).

Indeed, overreliance on *Murel* in this situation may be barred by the language of *Murel* itself. The court stated that the Act required *post-plan* interest payments to provide a secured creditor with complete compensation. However, the court plainly added that "[n]o doubt less [than complete compensation] will be required to hold up the suit for a short time until the debtor shall have a chance to prepare; much depends upon how long he has had already, and upon how much more he demands." *Id.* at 943.[13]

Our examination of the language of the adequate protection provisions suggests that they were intended to protect a secured creditor against a decrease in the value of its collateral due to the debtor's use, sale or lease of that collateral during the stay. There is little in the language of the statute to support a requirement that a debtor make periodic postpetition interest payments to an undersecured creditor, particularly when the Code makes it unmistakably clear that an undersecured creditor is not entitled to a claim for such interest at the conclusion of the proceeding. However, in using the "indubitable equivalent" language in § 361(3), Congress conceivably

intended to protect the *present value* of a secured creditor's collateral during the stay, rather than simply its *value*. Accordingly, we must conclude that § 361 is not only ambiguous on its face but also when considered in light of the interest provisions of the Code. We have already considered briefly the legislative history of the interest provisions of the Code, *see supra* note 8, and we turn now to the legislative history of the adequate protection provisions for further enlightenment.

III.

Helpful to an understanding of what Congress intended by the phrase "adequate protection" in the Code is a review of the law existing at the time the Code was enacted in 1978 and the preenactment history of the stay provisions, because Congress expressly indicated that it intended to codify certain aspects of the existing common law and rules. Further, "[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic National Bank v. New Jersey*, ___U.S.___, 106 S. Ct. 755, 760, 88 L.Ed.2d 859 (1986). That rule is "followed . . . with particular care in construing the scope of bankruptcy codifications." *Id. See also United States v. Whiting Pools, Inc.*, 462 U.S. 198, 208, 103 S. Ct. 2309, 2315, 76 L.Ed.2d 515 (1983) (construing provision of Bankruptcy Code to be "consistent with judicial precedent predating" Code at least when "[n]othing in the legislative history evinces a congressional intent to depart from" pre-Code practice). Committee hearings and the House and Senate committee reports accompanying respective versions of the proposed Code and statements by congressional leaders also provide important indications of congressional intent.

---

[13] *See In re Sun Valley Ranches, Inc.*, 38 B.R. 595, 598 (Bankr. D. Idaho 1984) ("those courts holding opportunity cost or the time value of money is compensible as part of adequate protection place unjustified reliance on [*Murel*] and the incorporation of Judge Learned Hand's metaphorical language in that case into § 361(3)"); *In re Smithfield Estates*, 48 B.R. 910, 914 n. 8 (Bankr. D. R.I. 1985) ("same protection necessary to insure the creditor the benefit of his bargain upon confirmation of a plan should not be imposed for interim protection during the stay"); *In re Shriver*, 33 B.R. 176, 183 (Bankr. N.D. Ohio 1983) (opportunity cost payments confuse adequate protection concept with cram-down requirements).

A. Pre-enactment History.

The rules Congress set forth in § 361 and § 362 regarding the automatic stay and the circumstances under which it might be lifted were not particularly innovative. Rather, even absent express statutory authority, the Supreme Court held as long ago as 1845 that the bankruptcy court had the equitable power to restrain creditors from enforcing liens after a bankruptcy petition was filed. *Ex parte Christy,* 44 U.S. (3 How.) 292, 11 L.Ed. 603 (1845); *see also Mueller v. Nugent,* 184 U.S. 1, 14, 22 S. Ct. 269, 274, 46 L.Ed. 405 (1902). And creditors' interests were not ignored before a lack of adequate protection was expressly codified as a reason for lifting the stay: "Case law had made adequate protection of the secured creditor a major consideration long before the [draft predecessor of the Code] proposed to codify it as a requirement." Webster, *Collateral Control Decisions in Chapter Cases: Clear Rules vs. Judicial Discretion,* 51 Am.Bankr.L.J., 197, 237 (1977).

[8] Protection of secured creditors' rights was frequently considered by the Supreme Court in connection with constitutional concerns raised by secured creditors. These cases primarily address creditors' rights at the time of confirmation of a plan but the principles they enunciate are equally applicable to stays at the outset, and provide guidance on the limits of the equitable powers of the court that remain valid. 2 *Collier on Bankruptcy,* ¶ 362.-01, at 362-11, 362-12 (15th ed. 1980). In general, the Fifth Amendment requires only that the value of the secured position of a creditor be maintained during the

stay.[14] Within this constitutional limit, general rules

---

[14] In *Wright v. Union Central Life Insurance Co.,* 304 U.S. 502, 58 S. Ct. 1025, 82 L.Ed. 1490 (1938), the Court discussed at length the relationship between Congress' power to affect secured creditors' interests and the limits on that power set forth in the Fifth Amendment:

> The mortgage contract was made subject to constitutional power in the Congress to legislate on the subject of bankruptcies. Impliedly, this was written into the contract between petitioner and respondent. . . . And the fact that in this case the purchaser at the foreclosure sale was also the mortgagee is not a determining factor. Any purchaser at a judicial sale must purchase subject to the possibility of the exercise of the bankruptcy power in a manner consonant with the Fifth Amendment. . . .
>
> If the argument is that Congress has not power to alter property rights, because the regulation of rights in property is a matter reserved to the states, it is futile. Bankruptcy proceedings constantly modify and affect the property rights established by state law. . . .
>
> A court of bankruptcy may affect the interests of lienholders in many ways. . . . Despite the preemptory terms of a pledge, it may enjoin sale of the collateral, if it finds that the sale would hinder or delay preparation or consummation of a plan of reorganization. It may enjoin like actions by a mortgagee which would defeat the purpose of [section 75(5)] to effect rehabilitation of the former mortgagor.

Id. at 515-18, 58 S. Ct. at 1032-34. In other words, the Fifth Amendment protects only the creditor's rights "to the extent of the value of the property." *Wright v. Union Central Life Ins. Co.,* 311 U.S. 273, 278, 61 S. Ct. 196, 199, 85 L.Ed. 184 (1940). As *Collier* states: "[t]his may well be the clearest statement of a [fifth amendment] right of a secured creditor, namely, to have the value of its secured position maintained throughout the proceeding. Thus an undersecured creditor is protected by the fifth amendment only to the extent of the *value* of his collateral rather than as to the *amount* of his total claim." 2 *Collier on Bankruptcy* ¶ 362.01, at 362-15 (15th ed. 1985). *But see* Rogers, *The Impairment of Secured Creditor's Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause,* 96 Harv. L. Rev. 973 (1983) (fifth amendment does not limit prospective exercise of Congress' bankruptcy power).

The Supreme Court in *In re New Haven Inclusion Cases,* 399 U.S. 392, 90 S. Ct. 2054, 26 L.Ed.2d 691 (1970), discussed the power of the bankruptcy court to approve a reorganization, and in the discussion referred to the relation between private property rights evolved in the courts governing the exercise of their equitable power to grant[15] or lift a stay. The courts developed four factors to determine whether to vacate a stay:

> (1) Would continuation of the stay result in an undue risk of material harm to the secured creditor?
>
> (2) Was there a reasonable possibility of reorganization or rehabilitation?
>
> (3) Was the property in question needed by the debtor or necessary to rehabilitation?
>
> (4) Was there any equity in the property that might be realized for the benefit of the debtor or its creditors?

Id. at 362-22, 362-23. Although "[a] positive answer on the first point . . . was almost invariably fatal to the debtor," in determining "whether to vacate the stay, courts tended to emphasize the need for judicial flexibility and the need to apply equitable considerations in determining the 'balance of the hurt.'" *Id.* at 362-23. The weight of the factors depended to some extent on the chapter of the Act governing the proceeding.

---

and the bankruptcy laws. The debtor's secured creditors had claimed that the lengthy period necessitated for reorganization "greatly depressed the value of [their] interest." *Id.* at 490, 90 S. Ct. at 2108. The Court stated:

> We do not doubt that the time consumed in the course of the proceedings in the reorganization court has imposed a substantial loss upon the bondholders. But in the circumstances presented by this litigation we see no constitutional bar to that result. The rights of the bondholders are not absolute.

Id. at 491, 90 S. Ct. at 2109.

[15] In time, under both the common law and the Rules of Bankruptcy Procedure, stays became automatically effective upon the filing of the petition. *See, e.g.*, Bankruptcy Rule 11-44.

In a Chapter X proceeding, involving a corporate reorganization, the stay was usually vacated if its continuance would result in "material harm" to a secured creditor, but the other factors were frequently important. *Id.* A creditor was not materially harmed by the stay when the value of its lien was maintained during the pendency of the stay. In the case of depreciating collateral, this typically required periodic cash payments or other transfers of value equal to the depreciation to be provided to the creditor.

However, in *In re Yale Express System, Inc.*, 384 F.2d 990 (2d Cir. 1967), the court arguably softened that requirement. *Yale Express* involved collateral (truck trailers) depreciating through use by the debtor. The court held that "to such extent as [the secured creditor] has been damaged by the use of its property pending the reorganization, it is entitled to equitable consideration in the reorganization plan." *Id.* at 992. In other words, the secured creditor apparently was entitled only to an administrative priority to compensate for depreciation; *Yale Express* seems to have adopted the dubious assumption that administrative expenses would be paid in full.[16] In *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971), the court retreated from *Yale Express*. To protect the creditor's interest in the collateral, the court ordered that the debtor periodically pay the secured creditors in cash for the "economic depreciation" of the collateral, *id.* at 369,[17] rather than force the creditor to accept a more risky administrative priority.

---

[16] The court in *Yale Express* refused the secured creditor's request for "rental payments" on the debtor's continued use of the collateral, noting that such payments "would nullify the reorganization" due to the debtor's inability to meet the payments. *Id.* at 992.

[17] Contingent on such payments, the court refused to lift the stay:

A Chapter XI petition proposed an arrangement, or "any plan by a debtor for the settlement, satisfaction, or extension of the time of payment of his unsecured debts, upon any terms." 8 *Collier on Bankruptcy* ¶ 4.01, at 343 (14th ed. 1976). Chapter XI's express stay provision, 11 U.S.C. § 714 (1976) (repealed 1978), allowed the court to enter a stay "for cause shown,"[18] and under the rules, the stay could be lifted "for cause shown," Rule 11-44(d). Because under Chapter XI a secured claim could not be affected by the arrangement, "stronger grounds should be required to continue the stay against a lienor in a Chapter XI case than would be required in a proceeding . . . under present Chapter X, and it should particularly be shown that continuation of the stay will cause no substantial injury to the lienor." 8 *Collier on Bankruptcy* ¶ 3.22, at 256 (14th ed. 1976). *See Lance, Inc. v. Dewco Services, Inc.*, 422 F.2d 778, 782 (9th Cir. 1970).[19]

> We are conscious of the deep concern of the manufacturing secured creditors that their security depreciate beyond adequate salvage, but we must balance that with the Congressional mandate to encourage attempts at corporate reorganization where there is a reasonable possibility of success.

Id.

[18] *See generally* Miller, *The Automatic Stay in Chapter XI Cases—A Catalyst for Rehabilitation or an Abuse of Creditor's Rights?*, 94 Banking L.J. 676 (1977). Bankruptcy Rule 11-44(a) later made the stay automatic and *ex parte* upon the filing of the petition, despite the language of the Act.

[19] In *Barth Equipment Co. v. Perlstein*, 128 F.2d 253 (2d Cir. 1942), the Chapter XI court considered an argument by an undersecured creditor that it was entitled to "a claim, as an expense of administration, for rental, or 'use and occupancy,' of the equipment during the period from August 1 [the date of the petition], when it

Chapter XII of the Act governed cases involving real property arrangements by persons other than corporations. Chapter XII also had express stay provisions, and a creditor could obtain relief from the stay "for cause shown."

B. Criticisms of Pre-Code Stay Provisions.

The automatic stay provisions of the Bankruptcy Act had the salutary goal of "protection of the estate of the bankrupt against the ravages that would be inflicted on the estate if grab law were allowed to govern." Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. Mich. J.L. Ref. 175, 187 (1977) [hereinafter cited as *Automatic Stay I*.] However, the estate's interests were not overriding; the stay was to be lifted "for cause," including material harm to a secured creditor. Thus Congress and the courts attempted to strike a balance between the interests of debtors, unsecured creditors and the public in the rehabilitative process, and secured creditors' rights to foreclose on collateral upon default.

In light of the harm that could befall secured creditors due to the stay, the bankruptcy rules provided that stay relief requests were to receive "priority" in the bank-

---

first became entitled to reclaim the equipment, to October 27 [the date the proceedings were dismissed]. There was never any agreement between the parties to pay such rental, and the claim is based solely on the delay in returning the equipment." *Id.* at 254. The court rejected the claim, stating that "the privilege of reclamation is not so absolute that its exercise may not be subjected to a reasonable delay." *Id.* Had the creditor immediately seized the equipment and sold it, the equipment could not also have been rented to a third party, therefore the creditor was not entitled to rental payments. The only damages recoverable would be "a drop, if any, in the market value of the goods." *Id.*

ruptcy courts. However, it appears that Congress's aspiration to expedite stay relief litigation was not realized:

> Unfortunately, it has been said that this provision of the rule is more honored in the breach than in the performance. It may be extremely difficult in an active bankruptcy court to disrupt scheduled proceedings to conform with the requirements of Rule 11-44(d). The intent of this provision, although laudatory, may be incompatible with the actual functioning and operations of the bankruptcy court under the present Act.

Miller, *supra*, 94 Banking L.J. at 704-05.[20] Delay also was due to procedure under the rules. A request for relief from the stay was initiated by a complaint in an adversary proceeding, which "caused significant difficulties in the administration of bankruptcy estates," because the debtor often asserted complex affirmative defenses or counterclaims. Peitzman & Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stays in Bankruptcy Proceedings*, 65 Calif. L. Rev. 1216, 1259 (1977). That, in turn, was "said to forestall prompt action on the request for relief from the stay." Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. Mich. J. L. Ref. 1, 40 n. 166 (1978) [hereinafter cited as *Automatic Stay II*].

C. History of Bankruptcy Reform Act.

1. Commission Proposals.

In response to numerous calls for reform of the bankruptcy laws, Congress established the Commission on

---

[20] *See also* Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. Mich. J. L. Ref. 1, 41 n. 169 (1978) (rule requiring precedence "frequently is not observed").

Bankruptcy Laws of the United States in 1970. After two years of research and public and private meetings, the Commission submitted a report on the bankruptcy laws and draft legislation to correct perceived inadequacies in the Act, particularly in the area of administration. The draft legislation accompanying the Report proposed to codify the common law standards for adequately protecting secured creditors during the pendency of the automatic stay. *Report of the Commission on the Bankruptcy Laws of the United States,* H.R. Doc. No. 137, pt. II, 93d Cong., 1st Sess. 236-37 (1973) [hereinafter cited as *Commission Report*].[21] The official comments accompanying the proposed legislation explained the purpose of the section:

> 1. This section is new. It is essentially a codification of such cases as *In re Yale Express System, Inc.*, 384 F.2d 990 (2d Cir. 1967) and *In re Bermec*. 445 F.2d 367 (2d Cir. 1971). *See generally* Festersen, *Equitable Powers in Bankruptcy Rehabilitation: Protection of the Debtor and the Doomsday Principle,* 46 Am. Bankr. L.J. 311, 324-33 (1972). . . .
> 3. . . . No attempt has been made to codify the case law as to when the use of collateral must cease or as to the adequacy of protection in any given situation. This is left to case-by-case development by the courts. A benchmark in determining the ade-

---

[21] *Section 7-203. Use of Property Leased or Subject to a Lien. (b) Relief from or Modification of Stay.* Pursuant to the Rules of Bankruptcy Procedure and section 4-501(c), a secured party or lessor may file a complaint (1) to terminate the stay, or (2) to modify the stay by imposing such conditions on the use of the property . . . as will adequately protect the secured party. The trustee or debtor shall have the burden of proving that the value of the secured creditor's interest in the property . . . as of the date of the petition is adequately protected.
Id. at 236.

> quacy of protection is the liquidation value of the collateral at the date of the petition. This is analgous [sic] to the "cram down" provision of § 7-303(7). *Conditions which may be imposed by the court, when appropriate, include (1) requiring other security of an equivalent value; (2) if there is no equity or the equity is marginal, requiring additional security to the extent of the anticipated decrease in the value of collateral as a result of use; and (3) giving a priority if it is clear that the proceeds of the liquidation of the property of the estate available to pay the claim will be sufficient.*

Id. at 236-37 (emphasis added). The "objective" of the Commission's proposal "was to permit use of the property subject to payments or other transfers that would compensate the secured creditor for the decline in recoverable value." Nimmer, *Secured Creditors and the Automatic Stay,* 68 Minn. L. Rev. 1, 8 (1983). The Commission's suggested standard for relief from the automatic stay clearly would not have allowed periodic interest payments for the delay in enforcing foreclosure rights.

2. Committee Hearings.

The Commission's draft legislation and alternative legislation drafted by the National Conference of Bankruptcy Judges were introduced in 1973 and 1974 and reintroduced in 1975.[22] Congress held extensive hearings

on the draft legislation throughout 1975 and 1976. *See Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 before the Subcomm. on Civil and Constitutional Rights, House Comm. on the Judiciary,* 94th Cong., 2d Sess. (1976) [hereinafter cited as *House Hearings*]; *Hearings on S. 235 and S. 236 before the Subcomm. on Improvements in Judicial Machinery, Senate Comm. on the Judiciary,* 94th Cong., 1st Sess. (1975) [hereinafter cited as *Senate Hearings*].

Numerous witnesses for secured creditors testified on the proposed legislation.[23] Insofar as the automatic stay provision was concerned, nearly all witnesses, including those representing secured creditors, favored retention of the Commission's provision in substance.[24] Numerous witnesses did suggest certain changes to address two concerns: (1) delay in reorganization proceedings, and (2) the danger of consumption of collateral, particularly "soft" collateral. For example, several witnesses advocated speed and flexibility in the reorganization process so that the proceedings could be concluded "in a matter of months rather than years." *House Hearings, supra,* at

---

[22] A detailed review of the enactment process of the Bankruptcy Reform Act is set forth by one of the principal drafters of the Code in Klee, *Legislative History of the New Bankruptcy Law,* 28 DePaul L. Rev. 941 (1979) [hereinafter cited as *Legislative History*], and by the Executive Director of the Bankruptcy Laws Commission, Kennedy, *Foreword: A Brief History of the Bankruptcy Reform Act,* 58 N.C. L. Rev. 667 (1980) [hereinafter cited as *Brief History*].

[23] Statements by a witness at a committee hearing may be relevant to a determination of congressional intent when the witness urges a change in a bill because of an assumed interpretation, or where witnesses "without contradiction" interpret the proposal in a particular way. *Whiting Pools,* 462 U.S. at 207 & n. 16.

[24] *See, e.g., House Hearings, supra,* at 1773 (testimony of Patrick A. Murphy) (automatic stay "is a real advantage"); *id.* at 435 (testimony of Peter F. Coogan) ("Any method that can be used to preserve the going concern value is likely to be a very substantial help to all of the creditors, as well as to the debtor. The interests are absolutely mutual in that respect."). *See* Kennedy, *Automatic Stay II, supra,* 12 U. Mich. J. L. Ref. at 64 (pre-Code litigation "has not generated a demand that the automatic stay be eliminated in the overhaul" of bankruptcy laws).

437.[25] Further, several contended that the Commission proposal did not adequately protect creditors against a decline in value of the collateral, particularly "soft" or "self-liquidating" collateral such as cash, accounts receivable, chattel paper, contract rights, and inventory.[26]

---

[25] *See also id.* at 482 (testimony of Patrick A. Murphy) ("vital that the rehabilitation process could be fast and flexible enough so that debtors and creditors can look to a bankruptcy proceeding as something that can be accomplished within a matter of months, rather than years"); *id.* at 1834 (testimony of Carroll G. Moore, Chairman, National Commercial Finance Conference) (debtor may "drag[ ] the case out" to detriment of secured creditor); *id.* at 2095 (statement of Richard A. Levine, U.S. Department of Justice) (automatic stay provision should be modified to "guarantee that prompt action will be taken" on motion for relief from stay).

[26] *Id.* at 1753 (statement of Robert J. Grimmig). A representative of the American Life Insurance Association reiterated this point:

> ALIA believes such use of mortgaged or leased property and the proceeds should be made subject to mandatory safeguards similar to those indicated in the Third Avenue Transit case [198 F.2d 703 (2d Cir. 1952)]. *The creditor or landlord should be compensated for the use or given other security of equivalent value or a priority claim against the estate in an amount equal to the economic decline in value of the property* (provided it is clear the estate will have sufficient assets to satisfy such priority).

Id. at 1608-09 (statement of John J. Creedon) (emphasis added).

Numerous other witnesses repeated the point. *See Senate Hearings, supra,* at 508-09 (statement of National Commercial Finance Conference) (Code should provide for "[p]eriodic payments to the secured creditor or lessor of amounts sufficient to cover deterioration, consumption, depletion or depreciation resulting from use"); *id.* at 522 (statement of National Commercial Finance Conference) (secured creditor should receive periodic payments during pendency of stay "to cover depreciation of the property or wear and tear"); *House Hearings, supra,* at 494 (testimony of Patrick A. Murphy) (secured creditor should receive protection "sufficient to maintain the value of his position throughout the proceedings"); *id.* at 1023 (statement of American Bankers Ass'n) (supporting stay if "it is clear that the value of the secured creditor's claim against the collateral will be preserved"); *id.* at 1607 (statement of American Life Insurance Ass'n) (secured creditor should be "fully protected" against "economic decline in value of the property"); *id.* at 1832, 1834 (testimony of Leon S. Forman, National Bankruptcy Conference) ("If

Several witnesses supported the Commission's general proposal to codify the common law standard protecting against depreciation during the stay, but suggested that various examples of how to provide protection to the secured creditor, which the Commission had set forth in its Comments, be codified.[27]

The simple fact is that in thirty-five days of in-depth hearings before the House subcommittee resulting in over 2700 pages of testimony from more than 100 witnesses, as well as in Senate hearings that were nearly as extensive, the subject of periodic postpetition interest payments for undersecured creditors was not raised in the testimony or prepared statement of a single witness.[28] Not one of

---

you are talking about equipment or real estate, if the debtor uses that, he is not going to do much harm. It is a fixed asset and it is going to be there for a long time. What the finance company is worried about is when he has cash, accounts receivable, and inventory as collateral.").

[27] *See House Hearings, supra,* at 1928:

> MR. KLEE [Subcommittee Associate Counsel]. Many representatives of secured creditors have also raised the point that section 7-203 should enumerate factors, many of which are specified in the Commission's notes, in the statute to guide the Court in deciding when property could be used subject to a lien; would any of you gentlemen be opposed to enumerating such factors in the statute, in a precatory manner?
>
> MR. ROCHELLE [National Bankruptcy Conference]. Assuming someone is smart enough to do it. There you really have a problem. Our feeling was, if I recall it correctly, that the matter should turn on the discretion of the court on a case-by-case basis. To endeavor to set out criteria specifically might have a limiting effect on the court.

id. See also id. at 1754 & n. 7 (statement of American Bankers Ass'n) ("suggested standards" set forth in Commission's notes should be included "in the text of the statute"); *id.* at 494-95 (testimony of Patrick A. Murphy) (section relating to adequate protection "should include specific alternative set forth in the statute").

[28] The only reference to the issue anywhere in the record is in two paragraphs of a law review article by Murphy that was included

the many witnesses for secured creditors even mentioned

---

in the record as a general explanation of the automatic stay provisions under the Act:

> Another possible condition for the continuation of the stay, one which the Commission failed to suggest, is to require the debtor to make interim cash payments to the creditor in an amount sufficient to compensate the creditor on a present basis for its anticipated loss. This was the approach adopted in *In re Bermec Corp.*, and has been the basis of most of the settlements between secured creditors and trustees, receivers and debtors under the existing Bankruptcy Act. Despite the attraction of the interim cash payments alternative, it is deceptively simple in several respects. To begin with, most secured financing is sufficiently generous that the scheduled payments approximate the depreciation of the collateral. If the debtor could have made the scheduled payments, it is likely that no proceeding under the Bankruptcy Act would have been necessary in the first place. Second, the court must decide whether the size of the payments should be based on liquidation value of the collateral or its fair market value, fair equivalent value or some other standard. Since it is unlikely the valuation will be exact, it would seem preferable to err on the high side. No real harm is done if the payments are in excess of the amount necessary to protect the secured creditor since each payment increases the debtor's equity in the collateral, which in turn benefits general creditors. Third, *if the interim cash payments alternative is used, perhaps the secured creditor should receive interest or compensation for its cost of funds.*
>
> *This last idea may seem shocking at first because it has been long recognized in bankruptcy that a secured creditor is entitled to the payment of interest only in the event that it holds surplus security above the amount necessary to cover principal.* If there is extra security, the rights of the secured creditor are not being jeopardized and interim payments are unnecessary. Nevertheless, the secured creditor in effect receives interest under the present Bankruptcy Act when the debtor in a Chapter XI proceeding just continues to pay his security obligations substantially according to their terms or works out an alternative payment schedule. If the stay of the marginally secured creditor is properly viewed as an involuntary loan of property to the debtor, there seems little reason not to afford the secured creditor some protection against the ravages of inflation and the fact that his own creditors have not given him an interest moratorium.

Murphy, *supra*, 63 Calif. L. Rev. at 1505-06 (emphasis added), *reprinted in House Hearings, supra*, at 1798-99. Murphy did not raise the idea with the committee in his lengthy testimony, nor did committee members question him about it.

the award of postpetition interest payments or sought compensation for the delay required by the stay. Viewed in this context, it seems unlikely that Congress intended the adequate protection provisions to require periodic payment of postpetition interest to an undersecured creditor.

3. Amendments and Committee Reports.

Following the committee hearings, the Commission's proposals were redrafted and reintroduced in the House and Senate. Thereafter, the legislation that became the Bankruptcy Reform Act of 1978 went through further revisions before its final enactment by Congress. Accordingly, statements in the legislative history must be carefully compared to the version of the bill to which they referred. As in most analyses of legislative history, "[t]he best method . . . is to begin with the most recent statement of authority and delve backward through the legislative process." Klee, *Legislative History, supra*, 28 DePaul L.Rev. at 957. However, we will begin by reviewing post-hearing amendments and the House and Senate Judiciary Committee reports although they are not the most recent statements of authority, because the final version of the bill may be more readily understood if the chronological development of its components is known.

Proposed § 362(d) of the House bill favorably reported by the Judiciary Committee on September 8, 1977, H.R. 8200, provided that the automatic stay could be lifted "for cause, including the lack of adequate protection of an interest in property" of creditor. The House Report stated that "[t]he interests of which the court may provide protection . . . include equitable as well as legal interests," citing as an example "a right to recover property under a consignment." *House Report, supra*, at 338, U.S. Code Cong. & Admin. News 1978, p. 6294. Section 361 was designed "to illustrate means by which [adequate protection] may be provided and to define the contours of the concept". *Id.* The Report summarized the concept of adequate protection:

> The concept is derived from the fifth amendment protection of property interests. *See Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 [61 S. Ct. 196, 85 L.Ed. 184] (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 [55 S. Ct. 854, 79 L.Ed. 1593] (1935). It is not intended to be confined strictly to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.

Id. at 339, U.S. Code Cong. & Admin. News 1978, p. 6295.

The Report discussed four "neither exclusive nor exhaustive" examples or means of providing adequate protection set forth in the House's proposed § 361. Codification of the examples was apparently in response to the suggestions of numerous witnesses for sercured creditors that the section drafted by the Commission gave too much

discretion to the bankruptcy judge. Proposed § 361(1), assertedly patterned on the protection devised in *In re Yale Express*, but actually closer to that set forth in *In re Bermec*, would permit "periodic cash payments by the estate, to the extent of a decrease in value of the opposing entity's interest in the property involved." *House Report, supra*, at 339, U.S. Code Cong. & Admin. News 1978, p. 6295. "[W]here, for example, the property in question is depreciating at a relatively fixed rate," periodic payments would "compensate for the depreciation." *Id.* Proposed § 361(2) provided for "an additional or replacement lien on other property to the extent of the decrease in value of the property involved." *Id.* That would "provide the protected entity with a means of realizing the value of the original property, if it should decline during the case. . . ." *Id.* at 339-40, U.S. Code Cong. & Admin. News 1978, p. 6296.

Proposed § 361(3), which was apparently based on *Yale Express*, would have granted "an administrative expense priority to the protected entity to the extent of his loss." *House Report, supra*, at 340 U.S. Code Cong. & Admin. News, 1978, p. 6296. Because the method would be "risky," it was only to be used "when there is relative certainty that administrative expenses will be able to be paid in full in the event of liquidation." *Id.*

Proposed § 361(4), a catch-all provision, would have allowed the court to grant "such other relief as will result in the realization by the protected entity of the value of its interest in the property involved." *Id.*[29] The report offered as an example a "guarantee by a third party outside the judicial process of compensation for any loss incurred in the case." *Id.*

---

[29] Paragraph (4) "also defines, more clearly than the others, the general concept of adequate protection, by requiring such relief as will result in the realization of value. It is the general category, and as such, is defined by the concept involved rather than any

The Report noted that all four methods "rely . . . on the value of the protected entity's interest in the property involved." *Id.* However, "[t]he section does not specify how value is to be determined, nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development." *Id.*[30]

The House Report was somewhat cryptic in its general discussion of "the contours of the concept" of adequate protection. The paragraph of the report that has provided the most support for the *American Mariner* line of cases is contained within this discussion, the statements that "[s]ecured creditors should not be deprived of the benefit of their bargain," *House Report, supra,* at 339, U.S. Code Cong. & Admin. News 1978, p. 6295, and that adequate

---

particular method of adequate protection." *Id.* In light of the dependence of the first three paragraphs on a decline in the value of the collateral, contemporary commentators suggested that subsection (4) simply was intended to allow alternate *means* of providing adequate protection. *See* Trost & King, *Congress and Bankruptcy Reform Circa 1977,* 33 Bus. Law. 489, 543 (1978) (§ 361 of H.R. 8200 "provides that '[w]hen adequate protection is required' under the Act, adequate protection is to be provided whenever there is a 'decrease in the value of [the secured party's] interest' ").

[30] The House bill apparently acceded to the complaint of secured creditors that "value" for purposes of § 361 determinations should not always be "liquidation value," as the Commission had recommended. However, it did not adopt the creditors' recommendation that "fully going concern value" be applied in each case. Rather, the bill avoided defining "value," and stated that the determination "must be based on equitable considerations based on the facts of the case." *Id.* at 339, U.S. Code Cong. & Admin. News 1978, p. 6295. In so doing, some commentators state that the Report "leaves the measure of 'realization of value' in a state of total confusion." Moller & Foltz, *Chapter 11 of the New Bankruptcy Code,* 58 N.C. L. Rev. 881, 900 (1980).

protection is intended to result in "realization" by the secured creditor "of the value of its interest in the property involved," *id.* at 340, U.S. Code Cong. & Admin. News 1978, p. 6296. The report does not explain the "benefit of their bargain" of which secured creditors should not be deprived. In the context of the entire report, however, it seems likely that the bargain referred to is the bargain to receive the collateral or its value upon default. Although the stay temporarily prevents that aspect of the bargain from being fulfilled, a creditor should not be prejudiced by a debtor's continued use of collateral during the proceeding. That bargain must be protected by compensating for a decline in the value of the collateral through its use during the pendency of the stay.

Meanwhile, the Senate was considering companion legislation, in which the language of proposed §§ 361 and 362(d) differed somewhat. Section 362(d) in the Senate proposal stated in part, as did the House version, that a party could obtain relief from the automatic stay "for cause, including the lack of adequate protection of an interest in property of such party in interest." The version of § 361 contained in the Senate proposal, S.2266, differed substantially from that in the House version, H.R. 8200, in that it did not incorporate the third and fourth subsections in the House's § 361; it specified only two ways of providing adequate protection. First, the Senate Committee report explained that § 361(1) would authorize periodic cash payments to compensate for depreciation, in accordance with the principles set forth in *In re Bermec.* Second, under § 361(2) the secured creditor might be protected against a "decline during the case" by "an additional or replacement lien on other property of the debtor to the extent of the decrease in value or actual consumption of the property involved." *Senate Report, supra,* at 54, U.S. Code Cong. & Admin. News 1978, p. 5840. The Senate Report stated that § 361 would be "consistent with the view expressed in *Wright v. Union Central Life Ins. Co.,* 311 U.S. 273, 61 S. Ct. 196, 85 L.Ed. 184 (1940), where the Court suggested that it was the value of the secured creditor's collateral, and not necessarily his rights in specific collateral, that was entitled to protection." *Senate Report, supra,* at 54, U.S. Code Cong. & Admin. News 1978, p. 5840. The Senate proposal contained no catch-all provision. Accordingly, it seems clear that the Senate version of § 361 would have protected only against a decline in value.

The Senate's version of § 361 openly favored secured creditors in one regard: the panel rejected "the granting of an administrative priority as a method of providing adequate protection to an entity as was suggested in *Ie re Yale Express*" and the House's § 361(3) "because such protection is too uncertain to be meaningful." *Senate Report* at 54, U.S. Code Cong. & Admin. News 1978, p. 5840.[31] The secured creditor was faced with too large a risk in the event of a decline in value of its collateral because the estate might be insufficient to pay all its administrative expenses. Further, the Senate's proposed § 362(d) favored secured creditors by placing a thirty-day limit for court action on motions for relief from the stay.

---

[31] The Senate bill "reflect[ed] a fear that any method" of protecting against economic depreciation other than periodic cash payments or a replacement lien on unencumbered property "would result in an increased risk to secured creditors." Downey, Ferriell & Pfieffer, *The Proposed Bankruptcy Reorganization Provisions: A Comparison of the Current Law with Chapter 11 of H.R. 8200 and S. 2266,* 18 Santa Clara L. Rev. 567, 588 (1978).

The Senate passed its bill as a substitute to the House's version on September 7, 1978. Because of the substantial differences in the House and Senate proposals, largely concerning the status of the bankruptcy courts, the leaders and staff members of the House and Senate Judiciary Committees "met, negotiated and agreed on many changes" in an effort to reconcile the two versions. 4 W. Norton, *Bankruptcy Law and Practice* ix n. 1 (1985). No conference committee was appointed. *Id.*[32] There is no formal or informal summary or transcript of these meetings in the published legislative history of the Code.

On September 28, 1978, the House took up the negotiated compromise that would become the new Code. Rep. Edwards' explanation of the agreed-upon changes on the floor of the House, "as a consensus of these committee leaders, carr[ies] a weight in the legislative history equal to a conference report." *Id.; see also* 124 Cong. Rec. 32,391 (1978) (remarks of Rep. Rousselot) (statement by Rep. Edwards has "the effect of being a conference report").[33] The committee leaders agreed to amend proposed § 362(d) to its current language, and also substantially altered § 361. The compromise version of § 361 deleted the House's method of providing adequate protection of a decline in value with an administrative priority. Further, the compromise inserted the words "indubitable equivalent" for the word "value," which had appeared in § 361(4) of the House version of H.R. 8200: relief other than periodic cash payments or a replacement lien, but not an administrative priority, might be granted to "result in the realization by [a secured creditor] of the indubitable equivalent of such entity's interest in such property." Rep. Edwards explained the compromise on the floor of the House immediately before the vote on it:

---

[32] *See* Klee, *Legislative History, supra,* 28 DePaul L. Rev. at 954 ("It was readily apparent that a House-Senate conference would not be fruitful because the crucial compromises to be reached would not be within the scope of the differences between the House and Senate versions of the bill.").

[33] The report of a conference committee is important to a determination of congressional intent, *Gemsco, Inc. v. Walling,* 324 U.S. 244, 264, 65 S. Ct. 605, 616, 89 L.Ed. 921 (1945), and "[b]ecause the conference report represents the final statement of terms agreed to by both houses, next to the statute itself it is the most persuasive evidence of Congressional intent." *Demby v. Schweiker,* 671 F.2d 507, 510 (D.C. Cir. 1981) (opinion of MacKinnon, J.).

> Section 361 of the House amendment represents a compromise between H.R. 8200 as passed by the House and the Senate amendment regarding the issue of "adequate protection" of a secured party. The House amendment deletes the provision found in section 361(3) of H.R. 8200 as passed by the House. It would have permitted adequate protection to be provided by giving the secured party an administrative expense regarding any decrease in the value of such party's collateral. In every case there is the uncertainty that the estate will have sufficient property to pay administrative expenses in full.
>
> Section 361(4) of H.R. 8200 as passed by the House is modified in section 361(3) of the House amendment to indicate that *the court may grant other forms of adequate protection*, other than an administrative expense, which will result in the realization by the secured creditor of the indubitable equivalent of the creditor's interest in property. . . . *Adequate protection of an interest of an entity in property is intended to protect a creditor's allowed secured claim*. To the extent the protection proves to be inadequate after the fact, the creditor is entitled to a first priority administrative expense under section 507(b).

> In the special case of a creditor making an election under section 1111(b)(2), that creditor *is entitled to adequate protection of the creditor's interest in property to the extent of the value of the collateral* not to the extent of the creditor's allowed secured claim, which is inflated to cover a deficiency as a result of such election.

124 Cong. Rec. 32,395 (1978) (emphasis added). Sen. DeConcini made an identical explanation of the bill before the Senate vote. Further, Rep. Butler, who was actively involved in drafting the bill and in negotiating the compromise between the House and Senate versions, stated on the floor of the House just before the vote on the compromise version that under the bill "[c]reditors are provided adequate protection of their interest during the course of a case and limitations are placed on the use of collateral." 124 Cong. Rec. 32,418 (1978). Rep. Butler explained when adequate protection would be required under the version of § 361 actually enacted: *"If a creditor is concerned that property is being misused or depreciating*, the creditor can demand adequate protection or relief from the automatic stay." *Id.* at 32,419 (emphasis added).

These are the clearest and most probative expressions of congressional intent concerning §§ 361-362(d). The clear implication of Rep. Butler's statement is that if property is not being misused or depreciating, then a secured creditor is not entitled to adequate protection payments. As for Rep. Edwards' explanation, if we recall what constitutes an "allowed secured claim," we define the "interest in property" that §§ 361-362 are designed to protect. First, an allowed claim may *not* include "unmatured interest," § 502(b)(2). *See* Fortgang & King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions,* 56 N.Y.U. L. Rev. 1148, 1150 (1981) ("Postpetition interest under the Code, as distinguished from the Bankruptcy Act, explicitly is made a *nonallowable* part of a creditor's claim.").[34] Second, a "claim is an allowed secured claim to the extent of the value of the collateral. . . ." Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code,* 53 Am. Bankr. L.J. 133, 152 (1979) [hereinafter cited as *Cram Down*]. Therefore, the remarks of Rep. Edwards strongly suggest that what was intended to be adequately protected by § 361 is the creditor's allowed secured claim —the value of its collateral.[35] It seems unlikely that § 361(3) was intended to require periodic postpetition interest payments when the very interest to be protected —the allowed secured claim—cannot itself include postpetition interest.[36]

The evolution of §§ 361-362 during the legislative process lends further support to this conclusion. The House-Senate meetings produced two compromises in § 361. The House proposal that § 361 include the provision regarding an administrative expense priority to compensate for a decline in the value of the collateral, as had been done in *In re Yale Express,* was deleted by the Senate, and the House-Senate conferees agreed on the deletion because of "the uncertainty that the estate will have sufficient property to pay administrative expenses in full." 124 Cong. Rec. 32,395 (1978) (remarks of Rep. Edwards). Further, the conferees agreed to include a general catch-all provision in the compromise version, as had been set forth in the final House version of the bill but not in the Senate version. However, they modified its language to state that the "indubitable equivalent" of the creditor's interest in the collateral must be protected, rather than the "value" of the interest as the House had recommended. Rep. Edwards did not explain the modification of the House bill to include "indubitable equivalent."

We are properly reluctant to place significant weight on the unexplained action of the conferees when they added the "indubitable equivalent" language, particularly when the mute change would alter settled law.[37] However, it seems likely that the following may have happened: the Senate refused to accept the House's codification of *In re Yale Express,* because that would have subjected creditors to too great a risk that they would not be protected against a diminution in value.[38] The House, on the other hand, prevailed as to the "catch-all" provision; the Senate version would have allowed *only* periodic cash payments or a replacement lien to compensate for depreciation, while the House version recognized "other relief," such as a guarantee by a third person or a bond. The Senate may have been reluctant to subject creditors to the vagaries of that subsection,

---

[34] Fortgang and King continue: "The House and Senate committee reports accompanying the Code make clear that this provision requires disallowance of interest unmatured at the date of the filing of the petition. . . ." *Id.*

[35] *See In re Keller,* 45 B.R. 469, 472-73 (Bankr. N.D. Iowa 1984) (adequate protection relates to the allowed secured claim and a secured creditor "will have an allowed secured claim to the extent of the value of the property securing its notes"); *In re Shriver,* 33 B.R. 176, 181 (Bankr. N.D. Ohio 1983) ("The 'interest in property' entitled to adequate protection under § 362(d)(1) then is the creditor's allowed secured claims.").

[36] *See also* Comment, *Automatic Stay Under the 1978 Bankruptcy Code: An Equitable Roadblock to Secured Creditor Relief,* 17 San Diego L. Rev. 1113, 1129 (1980) [hereinafter cited as *Equitable Roadblock*]:

> The first step in discerning whether the creditor's interest is adequately protected is to determine the value of the secured creditor's interest. This value is the amount of the debt plus any interest and expenses that would normally be added thereto. The creditor's right to adequate protection is limited to the lesser of the value of the collateral or the amount of the secured claim.

Id.

[37] Adoption and rejection of amendments are "readily available extrinsic aids to the interpretation of statutes." 2A *Sutherland Statutory Construction, supra,* at 341. However, "[u]nexplained changes made in a committee are not reliable indications of congressional intent." *Drummond Coal Co. v. Watt,* 735 F.2d 469, 474

(11th Cir. 1984). As the Court explained in *Trailmobile Co. v. Whirls,* 331 U.S. 40, 67 S. Ct. 982, 91 L.Ed. 1328 (1947), "[t]he interpretation of statutes cannot safely be made to rest upon mute intermediate legislative maneuvers." *Id.* at 61, 67 S. Ct. at 992. The Court in *Watt v. Alaska,* 451 U.S. 259, 101 S. Ct. 1673, 68 L.Ed.2d 80 (1981), recently applied this principle. The Court construed an amendment to a statute that was effected without explanation. The plain meaning of the amendment would have sharply altered existing law. The Court determined that Congress' "silence" on the change was suggestive because "Congress might be expected to have mentioned a change wrought through the amendment which would" effect a major change in the law. It added that although "[t]he silence of Congress may provide a treacherous guide to its intent[,] *Scripps-Howard Radio, Inc. v. FCC,* 316 U.S. 4, 11 [62 S. Ct. 875, 880, 86 L.Ed. 1229] (1942)," it would be "almost inconceivable that Congress knowingly would have changed substantially a long-standing formula . . . without a word of comment." *Watt v. Alaska,* 451 U.S. at 271 n. 13, 101 S. Ct. at 1680 n. 13.

[38] The author of Comment, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay,* 50 U. Chi. L. Rev. 305 (1983) [hereinafter cited as *Compensation for Time Value*], infers from the Senate's refusal to adopt *In re Yale Express* "that Congress chose not to impose *the risk* of the failure of reorganization on secured creditors." *Id.* at 313 (emphasis added). That conclusion is too broad: Congress' refusal to subject secured creditors to the very risky *In re Yale Express* does not necessarily mean that Congress intended to place *no* risk on them. There are many grades of risk.

so the conferees added the "indubitable equivalent" language to ensure that, if a court did not order less risky periodic payments or a replacement lien to compensate for a decline in the value of the collateral occasioned by the use, sale, or lease of the collateral by the debtor during the stay, the "other relief" unquestionably, or indubitably, would provide the creditor with the equivalent of the value of the property lost. Although, as we have discussed, the indubitable equivalent language was taken from *Murel Holding,* a cram-down case, no aspect of the legislative history indicates that the Senate's clearly expressed view as to the interest to be protected, namely the amount of the creditor's secured claim, was to be affected by the inclusion of the "indubitable equivalent" phrase in the compromise version. The legislative history is devoid of any indication that Congress meant to import wholesale the standards for adequate protection of secured creditors in a cram-down into the adequate protection provisions applicable during the stay.

The provisions underwent substantial revision in the legislative process, but the fundamental concept of the draft legislation that only depreciation of collateral must be protected against was not explicitly criticized or rejected at any point in the proceedings.[39] Further, at no point in the proceedings did Congress evince a decision to alter the settled rules regarding adequate protection and postpetition interest which the Commission attempted to codify. It seems likely that § 361 is merely "a codification of the case law that [had] developed under the [pre-Code] automatic stay rules," Kennedy, *Automatic Stay II, supra,* at 43 n. 177, except the rule of *In re Yale Express.*[40] Those rules did not permit periodic post-petition interest payments to an undersecured creditor. If Congress had intended to change those rules, the intention would have been clearly expressed not left to be inferred from isolated phrases in the legislative history. *Midlantic National Bank,* 106 S. Ct. at 760.

---

[39] Professor Kennedy, Executive Director of the Commission, stated that the "provisions for stays in the new law follow recommendations of the Commission." Kennedy, *Automatic Stay II, supra,* 12 U. Mich. J. L. Ref. at 5. *See* Nimmer, *supra,* 68 Minn. L. Rev. at 8 ("recoverable value approach to adequate protection is further suggested by earlier drafts of the current Code").

IV.

We turn now to other provisions of the Code that bear indirectly on the question, including some "provisions" that the courts have been forced to improvise, and to basic policies and procedures underlying the Code that will be directly affected by our resolution of the question.

A. The Cram-down Provisions—§ 1129.

We have seen that Judge Learned Hand in *In re Murel Holding Co.,* 75 F.2d 941 (2d Cir. 1935), held in the context of a proposed confirmation of a plan of reorganization, proposed by a debtor over the dissent of a secured creditor (one form of cram-down), that the dissenting secured creditor was entitled to the present value of its secured claim in cash or "a substitute of the most indubitable equivalence." *Id.* at 942. Judge Hand noted

---

[40] *See also Staff of House Subcomm. on Civil and Constitutional Rights, Comm. on the Judiciary,* 95th Cong., 1st Sess., *Table of Derivation of H.R. 8200* 5 (Comm. Print No. 6, 1977) (§ 361 derived from automatic stay provisions of Rules of Bankruptcy Procedure); *The New Federal Bankruptcy Code, supra,* at 93 (automatic stay and adequate protection provisions "were derived from the current Rules of Bankruptcy Procedure").

that the usual way the equivalent of a claim is provided in a plan of reorganization that contemplates a deferred payout of the claim is by paying a creditor interest on the amount of its claim. In 1978, Congress did codify the holding of *Murel,* as distinguished from its rhetoric, in the cram-down provisions of the Code.

In § 1129(b)(2)(A)(i), Congress clearly set forth the requirement of *Murel* that a secured creditor receive over time the *present value* of its allowed secured claim in order for a proposed plan of reorganization to gain court approval:[41]

> (2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:
>
> > [(A)(i)] (II) That each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property.

When the right of a creditor to payment of its allowed secured claim is delayed in the cram-down situation, Congress expressly ordered compensation for delay, in accordance with the holding in *Murel;* it failed to use similar language in § 362(d)(1) or in § 361. This supports a conclusion that Congress knew what it was doing when it expressly ordered that secured creditors receive interest payments for the deferral of their repayments in the cram-down situation, but failed to include language to the same effect in the automatic stay provisions. " 'Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion.' " *United States v. Wong Kim Bo,* 472 F.2d 720, 722 (5th Cir. 1972), *quoted with approval in Russello v. United States,* 464 U.S. 16, 23, 104 S. Ct. 296, 301, 78 L.Ed.2d 17 (1983). The cram-down provisions, therefore, strongly suggest that subsection (3) of § 361 was not intended to authorize present value payments to undersecured creditors to compensate for delay during the pedency of the reorganization proceeding.

---

[41] *See Klee, Cram Down, supra,* 53 Am. Bankr. L.J. at 155 n. 140 ("the provision that value is measured as of the effective date of the plan requires all payments to be discounted to the date using a present value analysis"); *House Report, supra,* at 413 (in connection with cram-down "[t]he property is to be valued as of the effective date of the plan, thus recognizing the time-value of money").

B. The Missing Provisions—Necessity and Invention.

Those courts that have adopted the *American Mariner* approach and required postpetition interest payments to an undersecured creditor on the value of its collateral have been faced with numerous questions for which the Code provides no guidance.

Because the only support in the statute for the payment of interest, the phrase "indubitable equivalent," does not even use the word "interest," and because some courts are understandably reluctant to speak in terms of interest in light of §§ 502, 506, which clearly preclude an undersecured creditor from receiving postpetition interest as part of its claim, many courts have latched onto the concept of compensating for "lost opportunity" through the adequate protection provisions. *See supra* note 1. Lost opportunity costs are said to be those amounts that an undersecured creditor would have earned if it had been permitted to foreclose on its collateral upon default, sell the collateral, and re-invest the proceeds, which the stay prevents. A formula for adequate protection is thus created, using at its base a hypothetical foreclosure and sale of actual collateral and a hypothetical re-investment of the proceeds. The problem that courts have struggled with is that the Code provides no instructions on how to fill in the blanks in the formula, namely (1) whether to compensate for lost opportunity costs from the date of the petition, the date of the motion for relief from the stay, or the date of a ruling on the motion; (2) whether to take into account the practicalities of delay in the state foreclosure process and delay in selling the property in order to realize something more favorable than a forced-sale price, during which a creditor would not be able to invest proceeds from its collateral; (3) whether to apply to the hypothetically re-invested proceeds of sale the contract rate of interest, or the current market rate, and, in that case, the long-term or short-term market rate; and (4) whether to apply "lost opportunity cost" payments that are actually made to the principal amount of the debt. Necessity being the mother of invention, courts have invented answers. Not surprisingly, the answers have varied markedly.

The bankruptcy court in the instant case ordered that postpetition interest payments begin six months after the petition was filed, because the court found that there would be a six-month delay in realizing proceeds from a foreclosure and orderly sale of the property. 49 B.R. at

458. *See also American Mariner*, 734 F.2d at 435 n. 12 ("the timing of adequate protection should take account of the usual time and expense involved in repossession and sale of collateral"). But in *Grundy National Bank*, 754 F.2d at 1441, the Fourth Circuit held that "interest should not begin" until the filing of a motion for relief from the stay, rather than the date that the petition was filed, and "[e]ven then the timing of interest should be postponed to take account of the time that would be subsumed in repossession and sale of the collateral."[42] The Code is silent on the issue.

The bankruptcy court in this case did not advert to the fact that the bankruptcy petition was filed on the eve of foreclosure, so that a portion of the six-month period had already elapsed. The court did acknowledge, and indeed recognized as a flaw, the fact that if the stay lifts at the end of the six-month period, the creditor will have to endure for a second time the six-month delay incident to foreclosure and sale, and is thus not actually compensated for lost opportunity. 49 B.R. at 458 n. 9. In effect, under this rule, the length of time that a debtor would have before adequate protection interest payments would commence would depend in part on foreclosure procedures in the forum state and in part on how long it would take the creditor to market the property in an orderly (non-forced sale) way, if the evidence establishes that the creditor would in fact market the collateral in that way. Nevertheless, the court determined that the rule, although "flawed," is "reasonable," because, in part, delay would further "the Congressional objective to promote reorganization." *Id.* In so doing, the court made explicit what

has perhaps been implicit in the decisions of numerous other courts engaged in determining when adequate protection interest payments should commence: the reorganization process will be aborted in a fashion inconsistent with the congressional objective of Chapter 11 to promote reorganization, if adequate protection interest payments commence immediately after the imposition of the stay, which is when opportunity costs begin to be incurred. These courts, in effect, compromise what are perceived to be conflicting requirements of the Code. By qualifying the creditor's right to postpetition interest in various fashions, they are able to further the congressional goal of promoting reorganization. But there is something anomalous about applying in a free-floating manner, with markedly varying results, a rule that depends for its very existence on the rule in *Murel Holding*, which itself is absolutely rigid in its application, regardless of the consequences.

Courts have also struggled to set an appropriate rate of interest for the hypothetically re-invested proceeds. *American Mariner* fixed the rate at the lower of the "market rate" and the contract rate. 734 F.2d at 435 n.12. Although perhaps fairer, this qualification makes little logical sense if § 361 was intended to fully protect a creditor's "opportunity costs"; the rate should always be the market rate, which will rarely be the same as the contract rate, because the hypothetically foreclosing creditor could rarely re-invest the proceeds at the contract rate. The court in *In re Victory Construction Co.*, 9 B.R. 570, 574 (Bankr. C.D. Cal. 1981), "found" a rate of 18% to be appropriate without discussion, in a case where the contract rate was 8%. The bankruptcy court in the instant case determined 12% was "the applicable rate . . . at the time that the creditor could expect to receive the foreclosure proceeds for reinvestment," six months after the petition was filed, and "assume[d] stable interest rates" absent contrary evidence. 49 B.R. at 458. There seems to be little discussion of whether the rates awarded are for long- or short-term investments. Presumably the bankruptcy court would be obligated to take evidence on the normal investment practices of the creditor seeking relief, as well as the likelihood that interest rates might change if that creditor normally placed its funds in short-term investments, despite the summary nature of automatic stay litigation and the need for speed. Again, the Code offers no advice on the issue.

---

[42] The bankruptcy court noted the tension between the Ninth and Fourth Circuits on this issue. 49 B.R. at 458 nn. 9-11.

Another difficult question is how to treat "opportunity cost payments" in the event of a successful reorganization. Courts addressing the issue seem to be uncertain about what to do with "*American Mariner* interest." *See generally* Fortgang & Mayer, *Valuation in Bankruptcy*, 32 U.C.L.A. L.Rev. 1061, 1088-90 (1985). The court in *In re Alexander*, 48 B.R. 110 (Bankr. W.D. Mo. 1985), stated that "*American Mariner* interest" is "wholly separate" from contract interest and speculated that it "may or may not go to reduce the other forms of interest which are meantime building." *Id.* at 119 n. 18.[43]

Finally, courts awarding "opportunity cost payments" will ultimately be forced to invent a refund procedure if a debtor is able to "cure" past defaults under § 1124(2). *See* Fortgang & Mayer, *supra*, 32 U.C.L.A. L.Rev. at 1089-90. That section allows a debtor upon proposal of a plan to cure defaults and reinstate the original terms of the loan, including the interest rate. In that event, the creditor is "unimpaired" and may not vote on the plan. If postpetition interest payments were ordered at a market rate higher than the contract rate, then a debtor who subsequently is able to "unimpair" the creditor under § 1124 (2) presumably would be entitled to a refund of excess interest paid when the terms of the original loan are reinstated. No refund provision appears in the Code. "Aside from the administrative inconvenience of such a course, the need to invent a procedure is proof that Congress never contemplated opportunity cost as adequate protection in light of § 1124(2)." *In re South Village, Inc.*, 25 B.R. at 998; *see In re Manville Forest Products Corp.*, 43 B.R. 293, 301-02 & n. 7 (Bankr. S.D. N.Y. 1984) (§ 1124(2) cannot be reconciled with postpetition interest payments in the guise of adequate protection payments).[44]

In *In re Victory Construction Co.*, 42 B.R. 145, 155-56 (Bankr. C.D. Cal. 1984), the court directly faced the issue of how to treat *American Mariner* payments when a debtor cured past defaults under § 1124(2) and a plan was confirmed. The debtor had been making interim "adequate protection payments" at the market rate of 18% of the value of the collateral in return for the stay.

---

[43] The court continued:

> If the creditor is oversecured and the arrearage is significant, it is obvious that the "loss of use" payments imposed by *American Mariner* may only diminish the additional interest charge for delay in payments and do little or nothing to deter the continual buildup of regular contract interest.

Id. In other words, the creditor would get interest on interest.

[44] *See also* Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and the Creditor's Bargain*, 91 Yale L.J. 857, 879 n. 101 (1982) (principle of Code that the advent of bankruptcy process is not a proper occasion for the assertion of greater rights than previously existed against the debtor "clearly is at odds with" recognizing these non-bankruptcy creditors' rights under state law within the bankruptcy process).

The contract rate was 8%. The court recognized that "one's first thought" would be to give to the debtor, and thereby other creditors, "the benefit of any excess over the contract rate" if a debtor is able to reinstate the original note. The court, however, had a second thought:

> But I do not think that any principle compels this result. From the start, the payment was something other than compensation under the contract. Judge Ordin in *Victory II* expressly recognized that he was ordering a (supposed) market, rather than the contract, rate. The debtor has paid it on that basis—and with the recognition that he might never recover any of it at all. [The] debtor may have credit against his adequate protection payments for interest at the contract rate on his ongoing contract obligation, *but . . . the creditor may retain the balance.*

Id. at 156 (emphasis added). In other words, the creditor received a temporary revision of its loan agreement to provide the higher market interest rate, simply because the debtor was in a reorganization proceeding. When the debtor cured past defaults and reinstated the original note, the creditor received precisely what it had bargained for. The "balance" that the court referred to clearly came from unencumbered assets that could have paid other creditors part of their principal. Although it is said that the purpose of the bankruptcy laws is not to rewrite deals for creditors to improve their investments, the *Victory Construction* ruling certainly had that effect.

C. Provisions Facilitating Speedy Proceedings.

The driving force behind the *American Mariner* line of cases is clearly the delay of the reorganization process, a delay necessitated by federal law which in effect imposes a monetary loss on all creditors. *See Nicholas,* 384 U.S. at 683, 86 S.Ct. at 1679. Although postpetition interest is not mandated by the Fifth Amendment, *see Wright v. Union Central Life Insurance Co.,* 311 U.S. 273, 278, 61 S. Ct. 196, 199, 85 L.Ed. 184 (1940); *Briggs,* 780 F.2d at 1342; *American Mariner,* 734 F.2d at 434 n. 8 ("no such protection is constitutionally required"), courts that award postpetition interest to undersecured creditors seem to be motivated by considerations of fairness: those creditors should not be placed in the deep freeze for an unreasonable period without some compensation for the delay.

Indeed, as noted above, delay was an overriding concern of Congress in recodifying the adequate protection and reorganization provisions in 1978. Witness after witness complained that the cumbersome procedures under the Act and inattention by the courts to motions for relief from the stay led to delay that did not serve the purposes of the bankruptcy laws. Congress responded to the complaints with numerous provisions of the Code that were designed to encourage a more rapid resolution of reorganization proceedings. Various sections—including §§ 305(a) (permitting dismissal or suspension of proceedings if interest of creditors and debtor would be served, such as when a reorganization or arrangement has been or is being effected in another forum), 1102(b)(1) (permitting continuation of prepetition creditors' committees), and 1126(b) (streamlining procedures for acceptance of plan, particularly prepetition solicitation of plan approval)—encourage speedy out-of-court workouts. Further, the debtor's exclusive right to file a plan is limited to 120 days, § 1121(b), unless extended "for cause," *see House Report, supra,* at 223, 231, and even the 120-day period may be reduced by the court "for cause," § 1121(d). Thereafter, a creditor may file a plan,

§ 1121(c). A creditor may move to dismiss the petition or convert the proceeding to a Chapter 7 liquidation if the debtor is dilatory. § 1112; *In re Shriver*, 33 B.R. at 188, or may move for appointment of a trustee, § 1104(a).

Most important, Congress provided that motions for relief from the stay are entitled to priority: if the court does not act on a motion for relief from the stay within thirty days, the stay automatically lifts.[45] The 30-day rule is the "most direct attack on the problem of delay and dilatoriness in dealing with requests for relief from the stay." Kennedy, *Automatic Stay II, supra,* 12 U. Mich. J. L. Ref. at 40 n. 166. Further, relief from the stay is now sought by means of a motion, rather than by the commencement of an adversary proceeding in which complicated counterclaims and offsets were often raised, requiring time consuming procedures to adjudicate. The legislative history of § 362(e) makes clear that the brief time periods allowed in § 362 litigation and the use of a motions procedure were designed to streamline and speed up the process:

> At the expedited hearing under subsection (e), and at all hearings on relief from the stay, the only issue will be the claim of the creditor and the lack of adequate protection or existence of other cause for relief from the stay. This hearing will not be the appropriate time at which to bring in other

---

[45] The stay automatically lifts 30 days after a § 362(d) motion is filed, unless the court after a preliminary hearing orders otherwise pending a final hearing, which must be commenced within 30 days of the preliminary hearing. § 362(e). The stay expires 30 days after the final hearing is commenced unless within that time the court denies the motion for relief from the stay or orders the stay continued pending conclusion of the final hearing.

> issues, such as counterclaims against the creditor on largely unrelated matters. Those counterclaims are not to be handled in the summary fashion that the preliminary hearing under this provision will be. Rather, they will be the subject of more complete proceedings by the trustees to recover property of the estate or to object to the allowance of a claim.

House Report, supra, at 344, U.S. Code Cong. & Admin. News 1978, p. 6300. *See also* 2 *Collier on Bankruptcy* ¶ 362.08[3], at 362-63 (15th ed. 1985). Finally, § 362 (d) motions require only limited notice to creditors.[46]

One conclusion from the legislative history is unassailable: Congress responded in 1978 to creditors' complaints about delay. It expressly did so by streamlining the stay relief litigation procedure, by building into the Code assurance that requests for relief from the stay will be considered in a timely manner and by providing all creditors with numerous means of limiting the delay of the reorganization process.

If the *American Mariner* position is accepted and undersecured creditors are entitled to periodic postpetition interest payments, perhaps at a rate higher than the contract rate and which (according to some courts need not be credited against principal, the end result may, in fact, be delay—contrary to Congress' clearly expressed intent to speed up reorganization proceedings. There would be little economic incentive for the undersecured creditor, particularly one whose prospects for a significant distribution on the unsecured portion of its claim are not bright, to cooperate in developing a negotiated plan. In many cases, delay would have little adverse effect on the creditor, and, in fact, the creditor might be rewarded for delay if the court allowed it to retain without adjustment the amount of the *American Mariner* payments above interest due under the contract. That very delay, however, will almost certainly adversely affect the unsecured creditors, as it is often the unencumbered assets, otherwise available for distribution to unsecured creditors, that are funding the interest payments to the undersecured creditors.

---

[46] The notice required for a § 362 motion is limited by local rule in the Southern District of Texas. The motion need be served only on: (1) the debtor, (2) the unsecured creditors' committee, if one has been appointed or elected; (3) all holders of liens on the property as to which relief from the stay is sought, "as scheduled by the debtor or otherwise known to the movant"; and (4) the twenty largest unsecured creditors. Local Rule 4001(a)(4) (effective Jan. 1, 1985). This requirement recognizes that other creditors may have an interest in the resolution of a § 362 motion. When a motion for relief from the stay is filed within a few days of the date that the petition was filed, before lists of creditors were or were required to be filed by the debtor, and before a creditors' committee is appointed, there is a real possibility that only the debtor will be aware of the motion and its potentially significant impact on other secured creditors and unsecured creditors.

A bankruptcy court, faced with a difficult and unpleasant decision whether, in effect, to terminate a reorganization case with bleak prospects for success, might well prefer to let the case continue and to assuage the undersecured creditor by ordering the payment of postpetition interest. But that very decision is a decision *for delay* and for increased expense, both in the form of interest and in the form of administrative expense, expense that in most cases will be funded by the unsecured creditors. A decision for delay—without a meaningful possibility that the delay will ultimately benefit creditors —is *not* the decision that Congress has made, and the obligation of the courts is to honor and effectuate the decisions that Congress has made to limit delay.

D. Interest Provisions—Procedure in § 506(b).

Awarding periodic postpetition interest payments to an undersecured creditor also seems inconsistent with the procedural mechanisms of §§ 506(b) and 506(c). Under § 506(c), the debtor may recover from property securing a creditor's allowed secured claim the reasonable and necessary costs and expenses of preserving or disposing of the property, to the extent of any benefit to the creditor. If, after reducing the amount of the allowed secured claim by the amount of that recovery, the creditor is oversecured, it is entitled to interest at the contract rate on its net allowed secured claim. § 506(b). The timing of the payment of accrued interest to an oversecured creditor (at the conclusion of the proceeding) is doubtless based on the fact that it is not possible to compute the amount of § 506(c) recovery (and, accordingly, the amount of the net allowed secured claim on which interest is computed) until the termination of the proceeding.[47] Consider by contrast the happier lot of the undersecured creditor under the *American Mariner* interpretation of § 361. Such a creditor is entitled to periodic interest payments on the value of its collateral, theoretically at the market rate (which may exceed the contract rate), without deduction for the § 506(c) recovery that cannot be computed until the termination of the proceeding. For example, in the case of collateral with a relatively short useful life and high costs of preserving the property, an undersecured creditor may be considerably better off receiving postpetition interest payments at the market rate on the value of the collateral (even if valued on a liquidation basis), than an oversecured creditor which is able to collect interest at the contract rate at the conclusion of the proceeding on what may by that time be a substantially reduced net allowed secured claim. Such a result, certainly conceivable under *American Mariner*, seems unusual.

---

[47] O'Toole, *supra*, 56 Am. Bankr. L.J. at 266 ("a secured creditor may never have an allowed secured claim for postpetition interest under section 506(a) until after the trustee or debtor in possession has finished preserving or disposing of the collateral").

The author concludes:

> In other words, section 506(b) is a timing provision. The Code denies the allowance of any claim for postpetition interest until after the plan is confirmed or the trustee disposes of the property. Section 506(b) directs the allowance of postpetition interest to the secured creditor only if the creditor is oversecured after the trustee has been compensated for the categories of expenses enumerated in section 506(c). Those expenses are the costs of preserving or disposing of the collateral to the extent the secured creditor is benefitted. It is impossible to determine the amount of the expenses the trustee has incurred until he has incurred them, and until the expenses have been incurred, section 506(b) forbids the allowance of postpetition interest.

Id. at 266-67.

E. Compatibility of Periodic Postpetition Interest Payments with Policies of Bankruptcy Code.

Probably the most troubling aspects of a construction of § 361 that would require or allow periodic postpetition interest payments to undersecured creditors are: first, its impact on the orderly procedures for the distribution of the debtor's estate either upon liquidation or reorganization; second, the resulting reallocation of the unencumbered assets of the debtor's estate that frequently occurs shortly after the petition is filed; and third, the resulting reallocation of the risk of failure of the reorganization proceeding.

To understand all three aspects, it is useful to understand a typical secured financing arrangement. As was noted by Murphy in the law review article included in

the record of the House hearings, *see supra* note 28, in many secured financing arrangements the scheduled principal payments approximate the depreciation of the collateral. Clearly, § 361(1) and (2) call for adequate protection payments to cover the decline in value caused by depreciation of the collateral. If § 361(3) is construed to further require postpetition interest payments on the value of the collateral, the total adequate protection payments will in many, perhaps most, cases approximate the principal and interest payments required by the existing terms of the secured debt instruments, because it will only be the interest on the unsecured portion of the secured debt that ceases to accrue. As Murphy pointed out, if the debtor could have made the principal and interest payments on its secured debt, it is unlikely that any proceeding would have been filed in the first place. In many Chapter 11 cases, including this one, the likely result of orders requiring periodic postpetition interest payments to undersecured creditors will be the immediate conversion to Chapter 7—a result which seems inconsistent with the congressional policy favoring attempts at reorganization.[48]

Further, since an undersecured creditor will have no claim for postpetition interest at the conclusion of the proceeding, it will be necessary for each such creditor to file a motion for adequate protection under § 362 immediately after the petition is filed or it will lose interest until it does file. As a practical matter, this means that all potentially undersecured creditors in a reorganization proceeding will file § 362 motions shortly after the petition is filed,[49] and the debtor will be immediately faced with demands for adequate protection payments by its secured creditors which will often approximate the total principal and interest payments on secured debt which it was required to make before the petition was filed.

---

[48] *See In re Keller*, 45 B.R. 469, 473 (Bankr. N.D. Iowa 1984) ("to follow the ninth circuit would in essence eviscerate the Bankruptcy Code and make Chapter 11 reorganization virtually impossible to accomplish"); *In re Wolsky*, 53 B.R. 751, 755 (Bankr. D. N.D. 1985) (*American Mariner* will have "destructive effect" on agricultural reorganizations). This conclusion recognizes that the reorganization proceeding could not continue after the unencumbered assets of the estate that were being used to fund the payments were exhausted, thereby requiring that the stay be lifted due to an inability to make further adequate protection payments.

Against this factual background, we consider the objectives of the automatic stay. As was eloquently stated in the House Report on § 362:

---

[49] Under *American Mariner* a substantial increase in the number of § 362 motions would be expected. In fact, statistics on § 362 motions filed in the Bankruptcy Court for the Southern District of Texas bear this out. As an initial matter, we note that the District Court Clerk's office does not maintain statistics on the number of § 362 motions filed in cases under each of Chapters 7, 11 and 13. However, because substantially all those motions are filed in cases under Chapters 11 and 13, the following statistics on the number of § 362 motions filed during August 1983 through March 1986 treat all such motions as having been filed in cases under Chapters 11 and 13. In the last five months of 1983, 1175 § 362 motions were filed, as compared with 1273 new Chapter 11 and 13 cases; that is equivalent to a rate of 92 motions for relief from the stay per 100 new cases. In 1984, the year that *American Mariner* was decided, 4392 motions for relief from the stay were filed, as against 3239 new filings, or a rate of 135 motions per 100 new cases. In 1985, the rate increased further, to 151 motions per 100 new cases (6408 motions, 4234 new cases). In the first three months of 1986, the rate grew to 163 motions for relief from the stay per 100 new cases (2375 motions, 1457 new cases). Creditors filed an average of 235 motions for relief from the stay per month in the last five months of 1983; they filed an average of 792 such motions per month in the first three months of 1986, an increase of 237%. New Chapter 11 and 13 filings were 90% higher in the first three months of 1986 than in the last five months of 1983. Many more § 362 motions are filed today than in years past, and these statistics make it clear that the increase is not due simply to an increase in new bankruptcy filings.

> The automatic stay is one of the fundamental debtor protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt a repayment or reorganization plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.
>
> The automatic stay also provides creditor protection. Without it, certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claim in preference to and to the detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.

House Report, supra, at 340, U.S. Code Cong. & Admin. News 1978, p. 6296. The scramble for the debtor's unencumbered assets by its undersecured creditors, which the *American Mariner* case has precipitated, bears little resemblance to the breathing spell devoid of a "race of diligence" described in the House Report.

The key to achieving a fair and equitable distribution of the debtor's assets contemplated by the House Report and by the Code, whether upon liquidation or reorganization, is complete information about the debtor's assets, liabilities, past business and prospects. The debtor is required to file comprehensive schedules of creditors, assets and liabilities, current income and expenditures, and a statement of financial affairs, § 521(1), either with the petition or within 15 days thereafter, unless the time is extended for cause shown, Bankruptcy Rule 1007(c). In the usual case, a meeting of the debtor and its creditors must be held not less than 20 nor more than 40 days after the petition is filed, at which the debtor is examined under oath. Rule 2003. A committee of unsecured creditors is required to be appointed, and one or more committees of other creditors may be appointed to secure adequate representation of various creditor groups. § 1102 (a). These committees participate in the investigation of the affairs of the debtor and in the formulation of a plan of reorganization. The purpose of the extensive information gathering that goes forward while the stay is pending is to put the debtor, its creditors and the court in a position to assess whether a plan or reorganization is feasible or desirable or whether the debtor must be liquidated. If the debtor or a creditor elects to go forward with a plan of reorganization, the Code provides a "carefully crafted scheme for creditor enfranchisement," *In re Braniff Airways, Inc.*, 700 F.2d 935, 940 (5th Cir. 1983), including § 1125 disclosure requirements, § 1126 voting requirements, and § 1129(a)(7), the best interests of creditors test. *Cf. In re Continental Air Lines, Inc.*, 780 F.2d 1223, 1226 (5th Cir. 1986). Further, under § 1129 (b)(2)(B), the absolute priority rule must be met in order for a plan of reorganization to be "fair and equitable," a prerequisite to plan approval absent consent. That rule provides that claims and interests must participate in the plan "in complete recognition of their strict priorities, and unless the value of the debtor's assets supports the extent of the participation afforded each class of claims or interests included in the plan," the plan cannot be fair and equitable. 6A *Collier on Bankruptcy* ¶ 11.06, at 210 (14th ed. 1977). *See Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 527, 61 S. Ct. 675, 685, 85 L.Ed. 982 (1941); *see also House Report*,

supra, at 415 ("[n]o class may be paid more than in full"). It seems obvious that the relative positions of creditors may be considered by the court, and the rule applied, only after the identity of each creditor, the amount owed and the extent to which the claim is secured or entitled to priority are known, not with precision, but at least with sufficient accuracy to assure that any proposed plan is feasible. Then, and only then, may the estate's unencumbered assets be divided among the various classes of creditors in accordance with their respective priorities.

The information gathering and creditor enfranchisement processes described above, which are designed to achieve a fair and equitable distribution of the debtor's assets, stand in sharp contrast to the abbreviated procedures which were established by Congress for the quick resolution of adequate protection motions. The speed, limited scope, and limited notice that are characteristics of a stay relief hearing strongly suggests that Congress did not intend the § 362 motion to be used as the vehicle for distributing unencumbered assets of the estate to the extent that would be required if adequate protection during the temporary pendency of the stay requires the complete compensation that is necessary for approval of a plan of reorganization contemplating deferred payments. Nor do those characteristics of a stay relief motion suggest that Congress intended that a series of § 362 motions filed by all the secured creditors in a case be dispositive of the outcome of the case with the frequency that is likely to occur if the debtor is compelled to make adequate protection interest payments approximating the total principal and interest payments on its secured debt. In summary, a construction of § 361(3) that would require interest payments to undersecured creditors seems inconsistent with the policy of the Code to promote an orderly distribution of the debtor's estate after a breathing spell designed to foster a careful assessment of the relative priorities of creditors and of the debtor's assets and prospects. Surely if Congress had intended to effect such fundamental changes in the way in which the automatic stay functions and in the way that the debtor's assets are distributed, it would have indicated that decision with clarity.

Finally, the leading Supreme Court cases on postpetition interest, such as *Vanston*, "indicate[] that secured creditors must also share some of the risks of the rehabilitation process. O'Toole, *supra*, 56 Am. Bankr. L.J. at 259. As things stood before *American Mariner's* interpretation of the adequate protection provisions, each creditor—secured or unsecured—bore its own cost caused by the delay inherent in a bankruptcy proceeding. Even an oversecured creditor, which is theoretically entitled to interest, in effect funded that interest out of the value of its collateral. Before *American Mariner*, therefore, the risk of failure of a reorganization proceeding was borne by all creditors. The effect of the *American Mariner* construction of the adequate protection provisions is most often to shift the costs associated with the delay in payment of the secured portion of an undersecured creditor's claim to the unsecured creditors. Interestingly enough, an oversecured creditor continues to fund its own interest, and, of course, unsecured creditors not only fund their own delay costs, but also most often[50] fund

---

[50] In the single asset case *sub judice*, in which the undersecured creditor is secured not only by real estate but also by an assignment

those of undersecured creditors. With that decision to reallocate costs, there is a corresponding decision to reallocate the risk of failure of the reorganization proceedings. Surely if Congress had intended such a major change in the allocation of the risk of failure of reorganization proceedings to unsecured creditors, it would have so indicated with greater clarity in the Code itself or in the legislative history.

V.

As noted above, the Ninth Circuit in *American Mariner*[51] and the Fourth Circuit in *Grundy National Bank*[52] hold that the Code mandates postpetition interest payments to an undersecured creditor as a matter of law.

---

of the rents, postpetition interest is to be paid, under the terms of the bankruptcy court's order, not out of unencumbered assets (there are none) but one out of the collateral (i.e., rents) securing the debt, although the debtor's obligation to pay the interest is not limited to the rents. This anomalous situation, in which "adequate protection" for the undersecured party's collateral is provided by consuming that collateral, contrasts with the lot of the oversecured creditor that, under the Code, cannot obtain adequate protection in the form of postpetition interest during the pendency of the case, but must wait until the end when it too is funded out of the collateral. Under the terms of an agreed cash collateral order currently in effect between Timbers and United, the net rents are being applied each month to debt service, presumably (although the record indicates some confusion on this point) to reduce United's debt. *See supra* Part II.A. The bankruptcy court's adequate protection order would, in theory, reclassify those payments from debt reduction to interest. However, since the net rents would be inadequate to make the required postpetition interest payments in full, the practical effect of the adequate protection order is simply to lift the stay.

[51] *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984).

[52] *Grundy National Bank v. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985).

Several bankruptcy courts and district courts,[53] as well

---

[53] The first post-Code court to raise the theory was *In re Anchorage Boat Sales, Inc.*, 4 B.R. 635 (Bankr. E.D. N.Y. 1980), which held that an undersecured creditor had "no right" to postpetition interest, but did have a right to the "present value" of its collateral due to "an undue risk of harm from the continuation of the stay" due to the debtor's commingling proceeds of the collateral. *Id.* at 642-43. Although the ruling appears to have been based on the depreciation and loss of the security due to the debtor's commingling funds, its use of the "present value" phrase has been cited as support for awarding postpetition interest payments. In *In re Virginia Foundry Co.*, 9 B.R. 493 (W.D. Va. 1981), the court expressly stated, without citation to authority, that the stay should be lifted because if the creditor foreclosed immediately, it would be able to invest the proceeds at the market rate, and that was part of a demand secured note entitled to adequate protection. *Id.* at 498. The court did not state whether the creditor was over—or undersecured, and did not discuss the Code's interest provisions. *In re Monroe Park*, 17 B.R. 934 (D. Del. 1982), was the first case to require that an undersecured creditor receive postpetition interest for the "delay [ ] in realizing the value of its interest by virtue of the automatic stay. . . ." *Id.* at 940. It also did not mention the interest provisions. *In re Langley*, 30 B.R. 595 (N.D. Ind. 1983), has been cited as authority for awarding monthly postpetition interest payments to undersecured creditors, but that case involved a marginally oversecured creditor.

Since the Ninth Circuit decided *American Mariner* in 1984, several lower courts have adopted its theory, most in express reliance on *American Mariner* without further analysis. *See In re Western Preferred Corp.*, 58 B.R. 201, 210 (Bankr. N.D. Tex. 1985); *In re Leavell*, 56 B.R. 11, 13 (Bankr. S.D. Ill. 1985); *In re Vanas*, 50 B.R. 988, 998-99 (Bankr. E.D. Mich. 1985); *In re Alexander*, 48 B.R. 110, 119 & n. 18 (Bankr. W.D. Mo. 1985); *In re Pulliam*, 54 B.R. 624, 625-26 (W.D. Mo. 1985); *In re Landsea Marketing, Inc.*, 53 B.R. 436, 437 (Bankr. C.D. Cal. 1985); *In re Wolsky*, 53 B.R. 751, 755 (Bankr. D. N.D. 1985); *In re Woodland Hills Village Development Corp.*, 54 B.R. 77, 78 (Bankr. D. Md. 1985); *In re Deeter*, 53 B.R. 623, 626-27 (Bankr. N.D. Ind. 1985); *In re Independence Village, Inc.*, 52 B.R. 715, 727 (Bankr. E.D. Mich. 1985); *In re Cash Currency Exchange, Inc.*, 52 B.R. 577, 580 (Bankr. N.D. Ill. 1985); *In re Lilyerd*, 49 B.R. 109, 117 (D. Minn. 1985); *First National Bank of Miller v. Wieseler*, 45 B.R. 871, 875 (D. S.D. 1985) (motion to use proceeds); *In re Air Vermont, Inc.*, 45 B.R. 931, 935 (Bankr. D. Vt. 1985); *In re Levine*, 45 B.R. 333, 338 n. 8 (N.D. Ill. 1984); *In re Mary Harpley Builder, Inc.*, 44 B.R. 151,

as a few commentators,[54] agree. The Eighth Circuit[55]

---

156 (Bankr. N.D. Ohio 1984). Many of these cases, of course, arose in the Ninth and Fourth Circuits, where *American Mariner* and *Grundy* are binding precedent.

[54] The *American Mariner* rule has attracted little support in scholarly writings. Periodic postpetition interest payments were first proposed by Patrick A. Murphy in 1975. Murphy, *supra*, 63 Calif. L. Rev. at 1506. Professor Thomas Jackson expanded on the proposal in *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 Yale L.J. 857, 874-75 & n. 80 (1982). *See also* Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 102 (1984); *cf.* Comment, *Good Faith Inquiries Under the Bankruptcy Code: Treating the Symptom, Not the Cause*, 52 U. Chi. L. Rev. 795, 814-16 (1985). The leading proponent of this view, Professor Jackson, has not attempted in his published writings to reconcile his interpretation of the adequate protection provisions of the Code wtih the Code's language and legislative history. *See* Baird & Jackson, *supra*, 51 U. Chi. L. Rev. at 99. Indeed, in *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, Professor Jackson recognized that his model suffers from "inadequate statutory firmness that permits—perhaps nurtures—the belief among bankruptcy judges that adequate protection can be granted without reliance on market-pricing mechanisms." 91 Yale L.J. at 877. Professor Jackson filed an *amicus* brief in the *American Mariner* case.

One commentator who appears to support *American Mariner* is Molbert, *Adequate Protection for the Undersecured Creditor in a Chapter 11 Reorganization: Compensation for the Delay in Enforcing Foreclosure Rights*, 60 No. Dak. L. Rev. 515, 529 (1984), who concludes that interest payments must be given for any period beyond 120 days of the date that the petition was filed due to the "equities" of the reorganization process.

Essentially the only writer to attempt to harmonize the proposal with the Code and its legislative history was the student author of Comment, *Compensation for Time Value*, *supra*, 50 U. Chi. L. Rev. at 309-22, who admitted that "[t]he legislative history does not specifically address whether adequate protection must include time value compensation." *Id.* at 311 n. 25. In sum, the view of most commentators is that there is a "paucity of support [for this approach] within the Code and its legislative history." Nimmer, *supra*, 68 Minn. L. Rev. at 10.

[55] *In re Briggs Transportation Co.*, 780 F.2d 1339, 1347-49 (8th Cir. 1985). Factors that the court suggested be taken into

has concluded that an undersecured creditor may be entitled to postpetition interest payments depending on the facts of the case, such as the "nature of the collateral and the proposed use of the collateral," but that it is not so entitled as a matter of law.[56] Finally, numerous bankruptcy and district courts,[57] as well as the majority of

---

account include the length of the stay, whether the collateral was depreciating, whether taxes were being paid so as to keep the property free of statutory liens, and the likelihood of successful reorganization. *Id.* at 1349.

[56] A handful of lower courts agree with this approach. *In re Peach State Distributing Co.*, 58 B.R. 873, 875-76 (Bankr. N.D. Ga. 1986) (court is "more inclined" to award "opportunity costs" in cases with low likelihood of successful reorganization, but such payments are not required as a matter of law); *In re B & W Tractor Co.*, 38 B.R. 613, 618 (Bankr. E.D. N.C. 1984); *In re First Century Trust Co.*, 12 B.R. 204, 208 (Bankr. W.D. Tenn. 1981); *General Motors Acceptance Corp. v. Anderson*, 6 B.R. 601, 610 (Bankr. S.D. Ohio 1980). A detailed commentary in support of this approach is set forth in Nimmer, *supra*, 68 Minn. L. Rev. at 2 (loss of recoverable value is "baseline consideration" in adequate protection determination, and further protection may be appropriate depending on "the nature and history of the loan transaction, the behavior of the parties, and the prospects of or activity toward reorganization").

[57] The great majority of lower courts that considered the issue prior to *American Mariner*, and several after it, held that a secured creditor is entitled only to protection against a decline in the value of its collateral through use, decay or depreciation. The leading cases in favor of this view are those of Judge Mabey in *In re South Village, Inc.*, 25 B.R. 987 (Bankr. D. Utah 1982), and *In re Alyucan Interstate Corp.*, 12 B.R. 803 (Bankr. D. Utah 1981). For other cases holding that §§ 361-362 protect only against depreciation in the collateral, *see In re Smithfield Estates, Inc.*, 48 B.R. 910, 914 (Bankr. D. R.I. 1985); *In re Sun Valley Ranches, Inc.*, 38 B.R. 595, 598 (Bankr. D. Idaho 1984); *In re Keller*, 45 B.R. 469, 473 (Bankr. N.D. Iowa 1984); *In re W.S. Sheppley & Co.*, 45 B.R. 473, 480 (Bankr. N.D. Iowa 1984); *In re Cantrup*, 32 B.R. 1004, 1005 (Bankr. D. Colo. 1983); *In re Shriver*, 33 B.R. 176, 183 (Bankr. N.D. Ohio 1983); *In re Pine Lake Village Apartment Co.*, 19 B.R. 819, 827 (Bankr. S.D. N.Y. 1982); *In re Ramco Well Service, Inc.*, 32 B.R. 525, 531 (W.D. Okla. 1983); *In re Saypol*, 31 B.R. 796, 800 (S.D. N.Y. 1983); *In re Aegean Fare, Inc.*, 34 B.R. 965 (Bankr.

commentators,[58] conclude that under no circumstances

D. Mass. 1983); *In re Wheeler*, 12 B.R. 908, 909-10 (Bankr. D. Mass. 1981); *In re Born*, 10 B.R. 43, 48 (Bankr. S.D. Tex. 1981) (Patton, J.) (adequate protection assures creditor that "he will not be faced with a decrease in the value of his collateral" during the pendency of the automatic stay); *In re Nixon Mach. Co.*, 9 B.R. 316, 317-18 (Bankr. E.D. Tenn. 1981); *cf. In re Manville Forest Products Corp.*, 43 B.R. 293, 302 n. 7 (Bankr. S.D. N.Y. 1984) (stating in § 1124 proceeding that opportunity cost payments are "inappropriate and of dubious universal application [at] this early triage stage").

[58] *See* O'Toole, *supra*, 56 Am. Bankr. L.J. at 263 (§ 361 requires adequate protection only against decrease in value of collateral); Rogers, *supra*, 96 Harv. L. Rev. at 995-96; Price, *Adequate Protection Under the Bankruptcy Act of 1978*, 71 Ky. L.J. 727, 734 (1983) ("The thrust of the adequate protection requirement is to assure maintenance of the value of the lien.").

The author of Note, *Adequate Protection Becomes a Creditor's Tool: In re American Mariner Industries, Inc.*, *supra*, challenged the analysis of § 361's legislative history set forth in *American Mariner*, 21 Willamette L. Rev. at 158-65. In Fortgang & Mayer, *supra*, 32 U.C.L.A. L. Rev. at 1075, the authors note numerous practical difficulties and logical inconsistencies in *American Mariner*, and labeled its reading of § 361 "somewhat disingenuous," *id.* at 1072 n. 49. Epstein & Fuller, *supra*, 38 Vand. L. Rev. at 913-15, note numerous analytical difficulties with *American Mariner*, most importantly its failure to distinguish "opportunity costs" from postpetition interest.

Other writings published shortly after enactment of the Code state that by § 361 Congress meant to protect against only a decline in value of collateral. Fortgang & King, *supra*, 56 N.Y.U. L. Rev. at 1154-56; Note, *Equitable Roadblock*, *supra*, 17 San Diego L. Rev. at 1132; Massari, *Adequate Protection Under the Bankruptcy Reform Act*, in W. Norton, 1978 *Annual Survey of Bankruptcy Law* 171, 173 ("Section 361 is designed to prevent loss or diminution of assets."); Barbee, *Business Reorganization Practice Under the Bankruptcy Reform Act of 1978*, 28 Emory L.J. 709, 726-27 (1979) ("purpose of 'adequate protection' is only to *preserve* a creditor's position at the time of initiation of the proceeding . . .; [i]f the value of a creditor's collateral will be eroded during the proceeding, that creditor . . . is entitled to protection from such erosion or to foreclose upon its collateral"). *See also* Axe, *Penetrating the Iron Curtain: Representing Secured Creditors in Chapter 11 Reorganization Proceedings*, 67 Marq. L. Rev. 421, 430-31 (1984) (concept of adequate may a Chapter 11 court award postpetition interest to an undersecured creditor in the form of periodic cash payments for adequate protection under §§ 361-362(d)(1), or otherwise criticize *American Mariner's* analysis.

The impact of *American Mariner* on this area of bankruptcy law is difficult to overstate. The decision has precipitated an avalanche of § 362(d) motions, *see supra* note 49, and, in many cases, has shifted the critical, indeed dispositive, point in the reorganization proceedings to a few weeks immediately following the filing of the petition. Because of the importance of *American Mariner*, we undertake a review of its analysis.

A primary difficulty with the opinion is that it does not allude to the only published portion of the legislative history explaining the versions of §§ 361-362(d)(1) as enacted, the explanations of Rep. Edwards and Sen. DeConcini that (i) § 361(3) was intended to permit "other *forms* of adequate protection" (emphasis added) than those set forth in §§ 361(1) and (2), and (ii) the adequate protection provisions only protect a creditor's allowed secured claim, which cannot include postpetition interest for an undersecured creditor.[59] Nor did the court refer to Rep. Butler's explanation that adequate protection payments or relief from the automatic stay would be appropriate if a creditor is "concerned that property is being misused or depreciating." Further, the court did not even cite, let alone reconcile its rule with, the Code's interest provisions or the leading Supreme Court cases, including *Vanston* and *Sexton*. Indeed, although the issue was framed before the Bankruptcy Appeals Panel as whether "an under collateralized secured creditor [is] entitled to postpetition interest upon the value of its collateral as a condition of denying relief from the automatic stay," 27 B.R. at 1005 (quoting brief of Crocker National Bank at 2), the Ninth Circuit avoided the point.[60]

---

protection "means that regardless of whether the secured creditor is undersecured or oversecured on the date of filing, its position should not deteriorate simply because the automatic stay is imposed, such that he suffers a loss of property or the benefit of his bargain").

[59] Only those statements refer to §§ 361-362(d)(1) as enacted. "Every other source . . . interprets an earlier version of the final legislative product." Klee, *Legislative History, supra*, 28 DePaul L. Rev. at 957-58.

The court in *American Mariner* did cite one aspect of a floor statement by Rep. Edwards, but its citation is not particularly helpful. In support of its conclusion that "Sections 361 and 362 include exceptional provisions specifically intended by Congress to benefit secured creditors at the expense of the debtor," 734 F.2d at 431, the court referred to a statement by Rep. Edwards " 'that creditors were not getting enough money out of bankruptcy proceedings to make it worth their while to participate in attempting to recover their money.' " *Id.* at 431 n. 6 (quoting 123 Cong. Rec. 35,446 (1977)). Rep. Edwards' quote, however, was taken out of context. The statement had nothing to do with adequate protection or periodic postpetition interest payments. Rather, it concerned administrative difficulties, most notably "professional administrators who do not act for the benefit of creditors." 123 Cong. Rec. 35,446 (1977) (remarks of Rep. Edwards).

[60] The court in ***In re Rankin***, 49 B.R. 565 (Bankr. W.D. Mo. 1985), set forth its remarkable view of the relation between the interest provisions and the adequate protection provisions when it ordered "*American Mariner*" interest to be paid:

> Under § 506(b) of the Code, an undersecured creditor, as here, is not entitled to accrue interest after the date of the filing. ***Thus interest may not be awarded as interest but the same amount may be awarded in another guise.***

Id. at 569 (emphasis added). Courts that have refused to award postpetition interest to an undersecured creditor, on the other hand, consistently note the direct conflict of the secured creditor's argument and the interest provisions. *See, e.g., **In re Pine Lake Village Apartment Co.***, 19 B.R. at 827; ***In re South Village, Inc.***, 25 B.R. at 997; ***In re Shriver***, 33 B.R. at 185.

We have already discussed the "indubitable equivalent" language in § 361(3) and when it was inserted into the Code. *American Mariner* placed significant, almost controlling, weight on inclusion of the phrase,[61] referring at length to the meaning of the phrase as used in *Murel Holding*. The Ninth Circuit assumed that the phrase had independent content identical to that in *Murel* and required an award of interest payments during the stay. The court distinguished *Murel's* statement that "[n]o doubt less will be required to hold up the suit for a short time until the debtor shall have a chance to prepare" on the ground that "[t]his qualification, of course, reflects the absence of a statutory requirement for adequate protection during the stay, not to mention the absence of a requirement for an automatic stay," 734 F.2d at 434. However, although there was no statutory requirement for adequate protection during the stay, the common law already had such a requirement.[62] In fact, Congress indicated that §§ 361-362(d)(1) essentially were intended to codify pre-Code law. Accordingly, the Ninth Circuit's conclusion that "[t]he early cases, decided before enactment of the Brankruptcy Reform Act of 1978, are of little relevance in construing sections 361 and 362," *id.* at 434, is difficult to square with settled rules of statutory construction.

The Ninth Circuit also placed significant weight on the language in the House Report that creditors should receive the "benefit of their bargain" despite the imposition of the automatic stay. The court implicitly assumed that

---

[61] "After examining the origins of the phrase and its use elsewhere in the Bankruptcy Code, we conclude that it at least encourages if not requires a present value analysis under section 361." 734 F.2d at 432.

[62] *See supra* notes 14-20 and accompanying text.

the bargain that a creditor and debtor enter into included compensation for the delay in foreclosure necessitated by federal law. But it seems unlikely that a creditor bargains for compensation for delay necessitated solely by the time-consuming reorganization provisions of the Code, since that would require a conscious assumption that its borrower might file a bankruptcy petition.

Furthermore, the "bargain" which the creditor enters into incorporates the applicable requirements of federal bankruptcy law. *Wright v. Union Central Life Insurance Co.*, 304 U.S. 502, 515, 58 S.Ct. 1025, 1032, 82 L.Ed. 1490 (1938) ("The mortgage contract was made subject to constitutional power in the Congress to legislate on the subject of bankruptcies. Impliedly, this was written into the contract between petitioner and respondent. . . ."). Two aspects of the law, of course, are the automatic stay provision of § 362(a) and the interest provision of § 502(b)(2) and § 506(b). The stay and the interest provisions themselves substantially alter the bargain of the parties.[63] The *actual bargain* struck, incorporating the interest provisions of the Code and nearly two centuries of its predecessors, is that if the creditor is undercollateralized when the time comes to "carve up the bird," the creditor will receive in respect of the secured portion of its debt only its "allowed secured claim"; it will not receive interest unmatured at the date of the bankruptcy filing. For this reason, using the "benefit of the bargain" language to support the payment of post-petition interest ignores what the parties actually understand to be the bargain. It also ignores the standard enforceability opinion by borrowers' counsel, which qualifies the enforceability of the debt instrument with the "bankruptcy out": the instrument will be enforceable "except as enforceability may be limited by bankruptcy, insolvency, reorganization or similar laws affecting the rights of creditors generally." Harter & Klee, *supra,* 48 Fordham L.Rev. at 277-78.

---

[63] "[I]t is artificial to speak of a 'bargain' in bankruptcy, when the law has intervened to change the contract made between debtor and creditor in many ways." O'Toole, *supra*, 56 Am. Bankr. L.J. at 273. *See* Harter & Klee, *The Impact of the New Bankruptcy Code on the "Bankruptcy Out" in Legal Opinions*, 48 Fordham L. Rev. 277, 279 (1979) (automatic stay "has a direct effect on the enforceability of the original agreement," therefore counsel should insert "bankruptcy out" in enforcement opinion to apprise client of "limitation on its scope"). *Cf.* Nimmer, *supra*, 68 Minn. L. Rev. at 4 ("Modification of the secured creditor's bargain is justified by the desire to provide an opportunity for the restructuring necessary to retain the going concern value of the debtor.").

One case decided under the Act expressly noted how bankruptcy laws can alter the bargain of the parties, even assuming that they contemplated the award of postpetition interest. In *In re Boston and Maine Corp.*, 719 F.2d 493 (1st Cir. 1983), *cert. denied*, 466 U.S. 938, 104 S. Ct. 1913, 80 L.Ed.2d 461 (1984), the court stated:

Further, it appears that the Ninth Circuit may have misinterpreted the compromise between the House and the Senate that led to the insertion of "indubitable equivalent" into the Code.[64] The Senate prevailed on the re-

---

> The two parties have bargained with reference to a specific security with the expectation that the creditor may sell this security and realize the entire amount of the outstanding obligation, including interest accrued to the date of payment. To deny such a creditor post-petition interest, *when the amount of the security is sufficient to cover both the principal and interest due,* would undermine the faith of lenders in the efficacy of credit arrangements. . . . Thus, granting post-petition interest to mortgages and other holders of contractual liens satisfies the expectations of the parties and strikes an equitable balance between the creditors and the debtors.

Id. at 497 (emphasis added).

[64] The *American Mariner* court analyzed the issue as follows:

> Although the Senate version of section 361 proposed to protect "the value of such entity's interest in such property," the section

quirement in its version that a creditor not be forced to take a risk that its collateral would decline due to the pendency of the stay. There is simply not a hint in the

---

> was considerably *more restrictive* than the House version. S. Rep. No. 989, 95th Cong. 2d Sess. 54, 1978 U.S. Code Cong. & Ad. News 5787, 5840. As a gloss on one of the two methods permitted by the Senate version for providing adequate protection, the Senate Report notes that the method was "consistent with the view expressed in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273, 61 S. Ct. 196, 85 L.Ed. 184 (1940), where the Court suggested that it was the value of the secured creditor's collateral, and not necessarily his rights in specific collateral, that was entitled to protection." *Id.* Read in the context of the broad scope attributed to the term "value" in section 361 and the wide range of interests to be protected, we think the citation to *Wright* cannot be construed to limit adequate protection to the value of the collateral. Nonetheless, no such gloss appears in the House Report on its version of section 361, and its *expansive approach* to adequate protection was ultimately adopted by Congress. The only reference to *Wright* in the House Report is the observation that adequate protection under section 361 is not confined to the constitutional protection required in *Wright*. H.R. Rep. No. 595 at 339, 1978 U.S. Code Cong. & Ad. News at 6295.

734 F.2d at 430 n. 4 (emphasis added). The court's conclusion that the Senate's version of § 361 was "restrictive" and the House's version "expansive" needs some explanation. The Senate version of § 361 provided creditors with far more protection than the House version of § 361, because it did not force them to accept uncertain and risky administrative priorities or unspecified "other relief," as did the House bill. Further, under the Senate's proposed § 362(d), relief was to be granted within 30 days of the hearing on the motion for relief, and relief was to be granted whenever the court found no equity in the property. Both these aspects of the Senate's bill were far more "pro-creditor" than the House bill. The only "expansive" aspect of the House bill was the language of the report accompanying it, which was not reflected in the text of H.R. 8200 as passed by the House. A cogent analysis of the language of the House report notes that although the "Code does not make any significant new contribution to the concept of adequate protection, but instead borrows the more effective devices developed by the courts under the Bankruptcy Act [, t]he House Committee Report's attempted restatement of those principles confuses the issues." Moller & Foltz, *supra,* 58 N.C. L. Rev. at 900.

remarks of Rep. Edwards that the compromise version significantly altered the scope of the interests to be protected set forth in each version of the legislation to that point.

Finally, as we have already discussed, *American Mariner* is marked by logical inconsistences, most notably those in its footnote 12, in which it attempts to set guidelines for determining the amount of the payments. Although these guidelines and qualifications have the salutary effect of facilitating reorganizations, they make little logical sense if § 361 in fact protects and undersecured creditor's "opportunity costs."

To the extent that the Eighth Circuit's opinion in *Briggs* follows *American Mariner*, it suffers from several of the same flaws. However, *Briggs* is far narrower than *American Mariner*. *Briggs* would require postpetition "interest" payments depending on the facts of the case, including the length of the stay, the "quality of the collateral," whether the "collateral's lien value is demonstrated to be appreciating, depreciating or remaining relatively stable," and "whether taxes and other payments designed to keep the collateral free of statutory liens are being paid or will be paid by the debtor." 780 F.2d at 1349. Of these factors, only the first, length of the stay, has anything whatever to do with accruing interest or "opportunity costs." There can be no doubt that the other factors mentioned should be taken into account by any court making a § 362(d)(1) adequate protection determination.

The flexibility accorded to the bankruptcy court by *Briggs* is attractive to those who fear that *American Mariner's* conclusion that undersecured creditors are entitled to postpetition interest payments as a matter of law will result in the wholesale, premature termination of Chapter 11 cases. Yet that very flexibility is difficult to reconcile with the language "indubitable equivalent" and with the inflexible requirement of complete compensation of *Murel* and the cram-down provision on which *American Mariner* is based. Further, the Eighth Circuit's opinion in *Briggs* gives the bankruptcy courts very little guidance and likely will require several years of litigation at the bankruptcy and appellate court levels before the parameters of the rule announced in *Briggs* become clear.

VI.

[9] We conclude that § 361(3) is designed to permit courts to grant "other relief," in addition to that set forth in § 361(1) (cash payments) and § 361(2) (replacement liens), to protect a secured creditor against a decrease in the value of its collateral occasioned by the use, sale, or lease of its collateral by a debtor during the automatic stay, but only if the "other relief" will indubitably provide the creditor with the value lost. Section 361(3) does not require periodic postpetition interest payments to an undersecured creditor to compensate it for the delay of the reorganization proceeding during the pendency of the automatic stay.

The district court's order insofar as it ordered Timbers to pay $7,956.00 monthly to the tax and insurance escrow is not challenged on appeal. The district court's order is reversed to the extent that it ordered Timbers to pay $42,500 monthly for "adequate protection of foreclosure rights." This matter is remanded to the district court for further proceedings not inconsistent with this opinion.

REVERSED AND REMANDED.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 85-2678

OPINION

IN RE:
TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Debtors.

UNITED SAVINGS ASSOCIATION OF TEXAS,
Movant-Appellee, Cross-Appellant,

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Respondent-Appellant, Cross-Appellee.

Filed July 9, 1986

Before: Clark, Chief Judge, Gee, Rubin, Reavley, Politz,
Randall, Johnson, Williams, Garwood, Jolly,
Higginbotham, Davis, Hill, and Jones,
Circuit Judges.

By The Court

Appeals from the United States District Court
for the Southern District of Texas
James DeAnda, District Judge, Presiding

OPINION

BY THE COURT:

A majority of the Judges in active service, on the Court's own motion, having determined to have this case reheard en banc.

IT IS ORDERED that this cause shall be reheard by the Court en banc with oral argument. The Clerk will specify a briefing schedule for the filing of supplemental briefs.

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

CIVIL ACTION NO. H-85-4529

BKCY. NO. 85-01453-H3-5

IN RE:
TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Debtor

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Appellant

v.

UNITED SAVINGS ASSOCIATION OF TEXAS,
Appellee and Cross-Appellant

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Cross-Appellee

(Filed September 23, 1985)

MEMORANDUM AND ORDER

Pending before the Court are Debtor's appeal and Creditor's cross-appeal from a decision of the Bankruptcy Court. Having considered the briefs of counsel, the facts, and the law, the Court is of the opinion that the decision of the Bankruptcy Court should be affirmed in all respects.

Debtor is a Texas limited partnership involved in the business of operating a multi-family apartment rental project located in Houston, Texas. Debtor filed its voluntary petition under Chapter 11 of the Bankruptcy Code on March 4, 1985, and continues in possession of its property as a debtor in possession. Creditor is the owner and holder of a promissory note in the principal amount of $4,100,000.00. The note is secured by a Deed of Trust and Security Agreement, which creates a lien on Debtor's apartment project. The market value of Debtor's apartment project, however, is considerably less than the principal amount of the note. Creditor is thus an undersecured creditor.

Creditor asserted in the Bankruptcy Court that for undersecured creditors the adequate protection provision of the Bankruptcy Code requires compensation for the lost opportunity to foreclose on the collateral and reinvest the proceeds. *In re American Mariner Industries, Inc.*, 734 F.2d 1436 (9th Cir. 1985). Debtor, however, argued that Creditor was only entitled to preservation of the value of the collateral. *See, e.g., In re Keller*, 45 B.R. 469 (Bkrtcy N.D. Iowa, 1984). The Bankruptcy Court adopted the reasoning and logic of the Ninth Circuit in *In re American Mariner Industries, Inc.*, holding that adequate protection of the undersecured creditor's rights requires compensation for the lost opportunity to foreclose on the collateral and reinvest the proceeds. Debtor's sole contention on appeal is that the Bankruptcy Court should not have adopted the *In re American Mariner Industries, Inc.* view.

This Court finds that the Bankruptcy Court was correct in following *In re American Mariner Industries, Inc.* and that the holding and the reasoning of the Bankruptcy

Court are correct in all respects. As the Bankruptcy Court noted in its opinion, the Fourth Circuit has expressly adopted both the holding and the reasoning of *In re American Mariner Industries, Inc. See Grundy National Bank v. Tandem Mining Corporation,* 754 F.2d 1436 (4th Cir. 1985). The Court would further note that since the rendition of the opinion by the Bankruptcy Court in this case the Eighth Circuit has also approved the reasoning of *In re American Mariner Industries, Inc. See In re Martin,* 761 F.2d 472, 475-478 (8th Cir. 1985); *In re Mannier Brothers,* 755 F.2d 1336, 1340-41 (8th Cir. 1985). Although the Fifth Circuit has not yet confronted this issue, this Court believes that it will follow the Ninth, Fourth, and Eighth Circuits. Debtor's appeal is thus denied.

Creditor cross-appeals asserting that the Bankruptcy Court miscalculated the adequate protection payments. The Court finds that *In re American Mariner Industries, Inc.* correctly sets forth the method of calculating the adequate protection payments in this case and that the Bankruptcy Court correctly calculated the amount and terms of these payments according to *In re American Mariner Industries, Inc.* Creditor's cross-appeal is thus denied.

Therefore, it is hereby ORDERED that the decision of the Bankruptcy Court be AFFIRMED in all respects and that the stay of the Bankruptcy Court's Order be DISSOLVED.

DONE in Houston, Texas, this 23rd day of September, 1985.

/s/ JAMES DeANDA
James DeAnda
United States District Judge

APPENDIX E

IN THE
UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSON DIVISION

Civil Action No. H-85-4529

(Judge DeAnda)

Bankruptcy Case
No. 85-01453-H3-5
(Chapter 11)

IN RE:
TIMBERS OF INWOOD FOREST
ASSOCIATES LTD., d/b/a
TIMBERS OF INWOOD FOREST
APARTMENTS, PHASE I,
Debtor

UNITED SAVINGS ASSOCIATION OF TEXAS,
Movant

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD., d/b/a
TIMBERS OF INWOOD FOREST
APARTMENTS, PHASE I,
Respondent

(Filed October 11, 1985)

ORDER GRANTING RELIEF FROM STAY

On the 11th day of October, 1985, came on to be heard the Motion of United Savings Association of

Texas for Withdrawal of the Reference of its Motion for Relief from Stay and for Entry of an Order Granting Relief From Stay Pursuant to Previous Order of the Bankruptcy Court. This Court, having considered the matter, is of the opinion that such motion should be granted.

IT IS, ACCORDINGLY, ORDERED that the reference of United Savings' Motion for Relief from Stay in this bankruptcy case, to the United States Bankruptcy Court for the Southern District of Texas, is hereby withdrawn. It is further ORDERED that the automatic stay in this case is hereby terminated, pursuant to section 362 (d) of the Bankruptcy Code, as to United Savings Association of Texas.

SIGNED this 11th day of October, 1985.

/s/ JAMES DeANDA
James DeAnda
U.S. District Judge

Presented by:

SCHLANGER, COOK, COHN,
MILLS & GROSSBERG

By: /s/ H. MILES COHN
H. Miles Cohn
5847 San Felipe, Suite 1700
Houston, Texas 77057
713/785-1700

Attorneys for United Savings
Association of Texas

CERTIFICATE OF SERVICE

THIS IS TO CERTIFY that on this 2nd day of October, 1985, a true copy of the foregoing document was delivered by messenger service to all counsel of record.

/s/ H. MILES COHN
H. Miles Cohn

APPENDIX F

In re BEAR CREEK MINISTORAGE, INC.
and Loch Katrine Center, Inc.,
Debtors,

REPUBLIC BANK HOUSTON, N.A.,
Movant,

v.

BEAR CREEK MINISTORAGE, INC.
and Loch Katrine Center, Inc.,
Respondents,

In re TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Debtor,

UNITED SAVINGS ASSOCIATION OF TEXAS,
Movant,

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Respondent.

Bankruptcy Nos. 84-06388-H3-5,
84-06389-H2-5 and
85-01453-H3-5.

United States Bankruptcy Court,
S.D. Texas,
Houston Division.

May 7, 1985.

Secured creditors moved for relief from automatic stay or for adequate protection. The Bankruptcy Court, Wesley W. Steen, J., sitting by temporary assignment, held that: (1) creditors' right to reinvest foreclosure proceeds was entitled to adequate protection, and (2) corporate debtors which owned real estate secured by indebtedness that exceeded value of real estate were required to make cash payments to creditors as adequate protection of creditors' right to reinvest foreclosure proceeds, since debtors were unable to provide other means of adequate protection, in monthly payments based on expected foreclosure proceeds and interest return that creditors would receive from reinvested proceeds.

Order accordingly.

Robert Collins, Houston, Tex., for Bear Creek Ministorage and Loch Katrine.

James Babcock, Houston, Tex., for RepublicBank Houston, N.A.

Leonard H. Simon, Houston, Tex., for Timbers of Inwood Forest.

H. Miles Cohn, Houston, Tex., for United Savings Ass'n of Texas.

MEMORANDUM OPINION

WESLEY W. STEEN, Bankruptcy Judge.

These three cases present the same legal issue. They were heard separately on April 17, 1985. This opinion assigns the reasons for the separate orders for adequate protection entered in each case. A preliminary draft of this opinion was provided counsel on April 19; this opinion is an editorial revision not possible on April 19 because of time constraints.

I. Similar Facts

The facts in each case are very similar. Each Debtor owns real estate that secures an indebtedness; when each case was filed, the sum due on the indebtedness exceeded the value of the security. Each secured Creditor filed a motion for relief from the § 362 stay. The value of the collateral is stable, *perhaps* slightly (but *very* slightly) appreciating. There was no evidence that the value of the collateral was depreciating.

II. The Law of Adequate Protection

Section 362(d) *requires* the Court to grant relief from the automatic stay effected by § 362(a) for cause, including the lack of adequate protection. Section 361 provides that adequate protection can consist of cash payment(s), additional and replacement liens, or "other relief . . . as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property."

There is no doubt that the Creditors' pre-petition liens are protected during the course of these proceedings. The Creditors assert, however, that they have another interest that should be protected: that is the right to foreclose and to reinvest (or relend) the foreclosure proceeds. Because the value of the collateral does not exceed the indebtedness, each day that the case proceeds the Creditors allegedly are losing a sum of money.[1] The asserted

lost value is the "time use value" of the proceeds that the Creditors would receive if they were allowed to foreclose. The Creditors seek adequate protection of that interest in the security.

[1] The issue of entitlement to protection of the value of the right to reinvest foreclosure proceeds has been squarely considered and decided: *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir., 1984). In that case the Ninth Circuit interpreted the applicable parts of the Bankruptcy Code as follows: (i) the interest entitled to protection under §§ 361 and 362(d) is "the secured creditor's interest and not merely the value of the collateral";[2] (ii) when the creditor is deprived of the specifically agreed benefit of its bargain,[3] the statute requires as a *quid pro quo* that the "value" of its bargain must be adequately protected; (iii) the test of adequate protection is twofold: first, the protection must adequately safeguard principal, and second, the protection must ". . . effectively . . . compensate the secured creditor for loss of value";[4] this latter element requires a calculation of the present value of the secured creditor's interest; and (iv) Congress intended in the Bankruptcy Code to increase the protection provided to creditors against potential injury from the interim stay against collection efforts;[5] therefore, the cases ". . . decided before enact-

---

[1] If the value of the collateral sufficiently exceeded the indebtedness that it secures, the same issue would be presented, *i.e.*, whether the foreclosure/reinvestment right is adequately protected, but the inquiry might be different; the Court would determine whether the creditor's right was adequately protected by the "equity cushion."

[2] 734 F.2d 426, 430.

[3] In this case, its right to foreclose on the property and to reinvest the proceeds.

[4] 734 F.2d 426, 432.

[5] This objective of increased creditor protection was discerned by the Ninth Circuit as demonstrated by enactment of the following

ment of the Bankruptcy Reform Act of 1978, are of little relevance in construing sections 361 and 362".[6]

In short, the Ninth Circuit concluded that the secured creditor's right to foreclose on the collateral and to reinvest the proceeds ". . . has substantial, measurable value . . ."[7] that is entitled to protection. The *American Mariner* analysis is clearly correct. In addition to being a sensible interpretation of the statute, the decision achieves a rational financial result. For example, if the value of collateral is a stable $500,000 and interest is 10%, a one year stay of foreclosure enforcement costs the creditor $50,000. The Ninth Circuit held that this right is entitled to protection.[8]

Having determined that the creditor's interest is entitled to protection, the Court must then decide what

---

parts of the statute: (1) automatic termination of the stay in 30 days unless the Court orders otherwise; (2) potential *ex parte* relief under § 362(f); (3) burden of proof on debtor to provide adequate protection; (4) expansion of "indubitable equivalent" test to temporary stay protection; (in its original application, Judge Hand limited the requirement to plan confirmation and intimated that lesser protection would suffice for temporary stays; the Ninth Circuit found that Congress' extension of this protection language to temporary stays evidences a Congressional intent to expand creditor rights to include protection of the time use value of money.) The Ninth Circuit also found evidence of this Congressional intent in the legislative history, particularly that cited in footnote 6 and in the text of the opinion at page 431.

[6] 734 F.2d 426, 434.

[7] 734 F.2d 426, 435.

[8] There is only one other circuit court opinion on the subject. In *Grundy National Bank v. Tandem Mining Corporation*, 754 F.2d 1436 (4th Cir., 1985), the Fourth Circuit followed *American Mariner*. One Bankruptcy Judge has followed *American Mariner, In re Mary Harpley Builder, Inc.*, 44 B.R. 151, 155-156 (Bkrtcy. N.D. Ohio, 1984). One has refused to apply its "Draconian Logic", *In re Keller*, 45 B.R. 469, 473 (Bkrtcy. N.D. Iowa, 1984).

protection will suffice; § 361 is the determinant. The debtor must provide cash payment(s), substitute lien(s), or other "indubitable equivalent[s]." The only protection that the Debtors can supply in these cases is cash payments because they have no other property or method with which to provide substitute liens or indubitable equivalents.

[2] The next question, then, is the amount of those payments. Unfortunately, *American Mariner* does not provide a formula. Because the statute protects the creditor's right to investment return on foreclosure proceeds, the protective payments should be a function of the price that could be realized on foreclosure times the rate of return the creditor could expect on reinvestmnet of the foreclosure proceeds. Thus the Court must determine the amount that would be realized on foreclosure, the rate of return on the proceeds, and the date when foreclosure would occur and investment return would begin. Obviously, none of these facts is susceptible of determination with mathematical precision.

The amount realized on foreclosure is difficult to determine both because it is difficult to determine the market in which the property will sell and because the evidence of prices available in each market consists of estimates and appraisals. Should the Court use the price that the property would bring at an auction or should the Court also consider the secured creditor's right to "buy in" the property at foreclosure and ultimately to realize a greater benefit through prudent delayed marketing of the property utilizing a more efficient market plan? In most cases, the former would bring a lesser price more quickly while the latter would bring a greater price somewhat later. The evidence in different cases might result in different determinations of what plan a prudent creditor might adopt.

The *ratio decidendi* of *American Mariner* is that the creditor has a right to protection of the present value of its right to foreclose and to reinvest the sale proceeds. To compute that present value, this Court assumes that the creditor would act as a prudent businessman and would follow reasonable, established marketing techniques, including purchasing the security itself at foreclosure in partial or full satisfaction of the indebtedness, followed by a reasonable and prudent effort to market the property. Since the creditor's right to foreclose would give it no financial benefit until the final sale to a third party of the property acquired at foreclosure, the payments by the debtor need not begin until that date in order to preserve the present value of the creditor's right to foreclose and to reinvest the proceeds. That is a serendipitous result for the debtor: the earlier that payments must begin, normally the smaller they will be.[9]

---

[9] This logic has at least one flaw. *American Mariner* dictates that "the usual time and expense involved in repossession and sale of collateral be considered." (footnote 12). But how? The instant opinion concludes that one must estimate the foreclosure delays, add that time to the bankruptcy filing date, and thus determine when adequate protection payments begin. But this is inadequate protection if the debtor does not successfully reorganize. Why? Because, although the stay will be lifted if the debtor fails to make an adequate protection payment, the foreclosure delays will have run twice without payment. The creditor will have lost investment return once during the *American Mariner* footnote 12 delays and once during actual foreclosure. The only solution is to require adequate protection payments from the date of filing. But this is contrary to footnote 12 of *American Mariner*. While the *American Mariner* solution is flawed, it is reasonable. Beginning adequate protection payments on filing would be impossible because of the delays required to litigate the amount and method of providing adequate protection. In addition,

In the cases at bar, the evidence indicated that a prudent creditor would itself purchase the property at foreclosure and would then market the property in the organized real estate market.

The applicable interest rate is difficult to determine because interest rates are normally a function both of the risk and of the term of the debt. Because *American Mariner* requires protection of the present value of the creditor's right to reinvest foreclosure proceeds, it would appear that the correct interest rate to apply is the rate that would be realized by the creditor when the proceeds are reinvested; in the cases at bar, that would be the creditor's lending rate. Because interest rates vary, the applicable rate would be the prevailing rate at the time that the creditor could expect to receive the foreclosure proceeds for reinvestment. Absent contrary evidence, the Court will assume stable interest rates in the cases at bar.

Finally, the Court must established the applicable hypothetical foreclosure date and reinvestment date in order to compute the date for valuation of the property and for determination of the interest rate; that date, of course, would also be the date on which payments must begin.[10] Returning to *American Mariner*, the objective is to compensate for the denial of the right to foreclose; absent

---

this solution, though flawed, recognizes and supports the Congressional objective to promote reorganization; if the reorganization is successful, the delays will have run only once, *e.g.*, the footnote 12 delays before adequate protection begins.

[10] Technically, the creditor's return would not begin until *after* the foreclosure. For example, if the foreclosure proceeds were collected at the end of the sixth month, then the creditor would begin to earn an investment return during the seventh month, after the foreclosure proceeds were invested. However, to *protect* earnings *during* the seventh month, this opinion requires payments to begin at the end of the sixth.

unusual circumstances, that denial arises upon entry of the order for relief, which is coincident with the filing of the case. The applicable date for valuation of the property and for estimation of the interest rate would be computed by adding the foreclosure delays to the date that the bankruptcy petition was filed.[11] The date thus computed would be the first date on which the creditor could expect a return on its interest in the property. Payments should begin on the same date. The evidence in the case at bar indicated the foreclosure period to be six months. The evidence in the cases at bar did not indicate any substantial changes in the prices or interest rates during the periods involved.

III. Summary and Application to Case at Bar

[3] In summary, the evidence in the cases at bar is that the Creditors' bargains were altered by the bankruptcy law on the date that the petitions in bankruptcy were filed. The Debtors must provide the Creditors with adequate protection for the Creditors' interests in the property by one of the methods specified in § 361. To compute the present value of the impingment, one computes the expected foreclosure proceeds and the interest return that the Creditors would receive if they had been able to exercise their rights to foreclose. To do so, one adds the prudent foreclosure marketing delay to the date of filing and assumes receipt of the value of the collateral and reinvestment of the collateral as of the end of the prudent foreclosure marketing period at a rate of return to be expected from the Creditors' business practices. When, as in the cases at bar, the Debtor can offer no alternative adequate protection, the § 362 stays can remain in force only so long as cash payments are made to the Creditors in the sums thus computed.

[4] Appendices A and B of this opinion contain the Court's findings in the cases at bar of foreclosure sale proceeds and comparable rates of return that the Creditors would realize if foreclosure proceeds were reinvested. Those attachments also show the computation of monthly payments necessary to protect the present value of the secured Creditors' delayed rights to foreclose. Separate orders have been entered in each case, requiring monthly adequate protection payments computed by using the expected foreclosure proceeds and a 12% annual rate of

---

[11] 734 F.2d 426, 435 text and footnote 12. *Grundy, id.* states that it adopts the *American Mariner* holding, but then states that "interest should not begin" until the filing of a motion for relief from the stay, but "[e]ven then the timing of interest should be postponed to take account of the time that would be subsumed in repossession and sale of the collateral" 754 F.2d 1436, 1441. If the *Grundy* court means that all computations start from the date of filing of the § 362(d) motion for relief, then the conclusion does not seem to be supported by logic or by *American Mariner*. The protection should be determined by the date on which that right to foreclose was impinged, not determined by when the protection was requested. *American Mariner* says that calculations are made from the date of the *petition*. *Grundy* might have construed that language to mean the date that the creditor "petitions for relief from the automatic stay." *See* 754 F.2d 1436, 1441. But the proper pleading for relief from the stay is a motion. The "petition" referred to in *American Mariner* is more likely the petition for relief filed by the debtor. If *Grundy* means that adequate protection *payments* may not begin until after a motion for § 362(d) relief is filed even though the applicable delays are calculated from the date of the petition, then the result is reasonable; that limitation would prevent hardship to the Debtor caused by a "late" § 362(d) motion that could require sizeable "make-up" payments for which the Debtor had not planned. It is not unreasonable to require the creditor to be vigilant in requesting protection if it wants protection. That issue of when payments start is not affected in the case at bar by the date that the motion for relief was filed because it was filed prior to the earliest date when adequate protection payments would begin, either under *American Mariner* or under *Grundy* (as interpreted herein).

interest (1% per month). The interest rate is established by testimony that the Creditors would receive approximately that return from reinvestment of foreclosure proceeds.

IV. Analysis of Argument by Counsel

[5] Counsel for one of the Debtors stated that this holding means that the debtor must fund adequate protection either through net operating revenues or through capital contributions; he said that such a requirement reduces (and potentially eliminates) the Debtor's ability to reorganize. That comment is well founded in the cases at bar. The result is inescapable, however, since that is the only way in these cases to protect the creditor's statutory and potential constitutional rights[12] in the collateral. The result is not as unfair as counsel suggests, however. If the Debtors cannot even fund the present value of foreclosure rights in the collateral, they have little equitable claim to a right to reorganize. Because time runs inexorably, and because money has a time use value, *someone will fund* the time use value of an undersecured debt if the stay remains in force. No statute or court decision can alter that financial fact. The question is *who* will fund it: debtor or creditor. Continuation of the stay without creditor compensation requires the creditor to fund the stay; there is no statutory authority for such a result. To the contrary, the Ninth Circuit correctly concludes, the statute requires protection of the creditor's interest.

The second argument urged by counsel is that the allowance of "interest payments" would be inconsistent

---

[12] The *American Mariner* court did not reach the constitutional issue because it found statutory protection for the creditor's interest.

with other sections of the Bankruptcy Code, specifically § 502(b) that disallows interest on the claim of an unsecured creditor. This argument is not well founded. This decision only allows protection for the interests of a secured creditor. To the extent that a creditor has a claim in excess of the value of the collateral, no protection is available under this decision. Only the secured portion of the claim is entitled to protection.

V. Use of Cash Collateral

[6] In Case Number 85-01453, *Timbers of Inwood Forest Associates,* 49 B.R. 454 (Bkrtcy. S.D.Tex., 1985) the Creditor holds an assignment of rents as additional security for the loan. There currently exists an agreed order for use of cash collateral under the terms of which the debtor is allowed to pay the operating expenses of the apartment complex from the cash collateral and is directed to pay the remainder of the cash collateral to the secured creditor. The Debtor argues that if adequate protection is awarded for the Creditor's interest in the real estate under the *American Mariner* doctrine, then such adequate protection is in lieu of security for the use of cash collateral and, therefore, the agreed cash collateral order should be revoked. The consequence of such a rule would be that the Debtor could keep and could use the excess cash collateral as it pleases if the *American Mariner* adequate protection payments are less than the net operating revenue.

The Debtor's argument is not well founded; it misreads the Bankruptcy Code and *American Mariner.* The creditor in the case at bar has one debt due, but it has two interests in property as security for that debt: *viz.* a deed of trust and an assignment of rents. The Code, as interpreted by *American Mariner* and by this Court, entitles the creditor to protection of its interest in the security; thus, the *American Mariner* payments do not protect the indebtedness due to the creditor; the payments protect the creditor's interest in the securiy, including the foreclosure interest in the security. The assignment of rents, cash collateral, is additional security for the indebtedness.

The debtor can deprive the creditor of the creditor's interest in the rents (cash collateral) only if the debt is less than the total security (and thus if the creditor is oversecured and, therefore, adequately protected). That is not the situation in the case at bar. But what, as in the case at bar, if the value of the cash collateral plus the value of the real property collateral is less than the indebtedness. Does the creditor have a right to protect its interest in the cash collateral (assignment of rents) and to receive periodic *American Mariner* payments in addition? That issue need not be decided at this time. It was not raised in the pleadings or at the hearing of this case. Therefore, the Court has not considered the question.

APPENDIX A

Timbers of Inwood Forest Associates
Case No. 85-01453-H3-5

Indebtedness as of April 12, 1985		$4,366,388.77
Monthly accruals:		
Interest	$45,842.06	
Taxes & insurance escrow	7,956.00	
Total		$53,798.06
Amount realizable on foreclosure		$4,250,000.00
Time to realize foreclosure proceeds		6 months
Appropriate interest rate		12%
Date of filing		March 4, 1985

Monthly Payments Required

6 months from date of filing		September 4, 1985
Monthly payments due from 5/4/85-8/4/85		$7,956
Monthly payments beginning 9/4/85:		
Adequate protection of foreclosure rights	$42,500	
Taxes & insurance escrow	7,956	
Total		$50,456

In addition, Debtor shall make payments each month sufficient to amortize any deficiency in the escrow account between the date of this order and the date payments are required to be made from the escrow account.

APPENDIX B

Bear Creek Mini-Storage, Inc.
Case No. 84-06388-H3-5
Loch Katrine Center, Inc.
Case No. 84-06389-H2-5

Indebtedness as of April 17, 1985	$3,067,660.40
Monthly interest accrual	$ 26,961.90
Amount realizable on foreclosure	$2,575,000.00
Time to realize foreclosure proceeds	6 months
Appropriate interest rate	12%
Date of filing	December 13, 1984

Monthly Payments Required

6 months from date of filing	June 30, 1985
Monthly payments due beginning June 30, 1985	$25,750

There was no evidence presented at hearing concerning escrows for insurance and taxes.

APPENDIX G

IN THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF TEXAS HOUSTON DIVISION

CASE NO. 85-01453-H3-5

IN RE:
TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.
DEBTOR

United Savings Association of Texas
Movant

v.

Timbers of Inwood Forest Associates, Ltd.
Respondent

ORDER

For the reasons assigned in the memorandum opinion issued this date, it is ORDERED:

(1.) The Debtor shall pay to United Savings Association the sum of $7956 per month beginning May 4, 1985, and on the 4th day of each calendar month thereafter until, and including, August 4, 1985.

(2.) If there are any deficiencies in the tax and insurance escrow account as of April 30, 1985, the Debtor shall add to the monthly payments specified above and to the monthly payments specified below a sum sufficient to amortize the deficiency in equal monthly payments beginning May 4, 1985, and ending on the date payments are required from the escrow fund for which the funds then on hand are projected to be insufficient.

(3.) Beginning on September 4, 1985, and on the 4th day of each month thereafter until this obligation modified by plan confirmation or by further order of the Court, the Debtor shall pay to United Savings Association the sum of $50,456.

(4.) The stay provided by § 362 shall remain in effect. In case of default on any of the obligations specified above, United Savings Association shall give the Debtor by Certified Mail, Return Receipt Requested, 10 day written notice and opportunity to cure the default. In case of failure to cure the default within said period, the Court shall grant relief from the stay upon *ex parte* motion accompanied by an affidavit of the circumstances of the default of the required notice herein, and of the failure of the Debtor to cure said default.

(5.) Payments under subparagraphs 1-3 may be made from rental receipts otherwise subject to the agreed cash collateral order herein. However, the agreed cash collateral order is not otherwise amended.

Houston, Texas, this 19th day of April, 1985.

/s/ WESLEY W. STEEN
Wesley W. Steen
U.S. Bankruptcy Judge

APPENDIX H

Summary of Decisions Re Time Value Compensation

The following is a circuit-by-circuit summary of cases decided under the Bankruptcy Code that address the issue of whether an undersecured creditor is or may be entitled to adequate protection of the "time value" of its interest in collateral. Lower court decisions in the Fourth, Fifth, Eighth and Ninth Circuits are not included.

D.C. Circuit:	No decision	
D.D.C.	Probably	*In re 12th & N Joint Venture*, 63 B.R. 36, 39 (Bankr. D.D.C. 1986) (citing *American Mariner* and *Briggs* favorably).
	Probably not	*In re Hagel Partnership, Ltd.*, 40 B.R. 821, 822-23 (Bankr. D.D.C. 1984) (pre-*American Mariner;* however, debtor offered to cure defaults during case).
1st Circuit:	No decision	
D.R.I.	No	*In re Smithfield Estates, Inc.*, 48 B.R. 910, 914 & n. 8 (Bankr. D.R.I. 1985) (rejecting *American Mariner*).
D. Mass.	Unclear	*In re Park West Hotel Corp.*, 64 B.R. 1013, 1020 (Bankr. D. Mass. 1986) (declining to reach issue because creditor was oversecured, noting that issue "may well require resolution by the United States Supreme Court").
	Yes	*In re Harrington & Richardson, Inc.*, 48 B.R. 431, 433 (Bankr. D. Mass. 1985) (approving *American Mariner*).
	No	*In re Aegean Fare, Inc.*, 34 B.R. 965, 969 (Bankr. D. Mass. 1983) (pre-*American Mariner*).

2nd Circuit:	No decision	
D. Vt.	Probably	*In re Air Vermont, Inc.*, 45 B.R. 931, 935 (Bankr. D. Vt. 1985) (citing *American Mariner* favorably in dicta).
D. Conn.	Unclear	*In re U.S. Repeating Arms Co.*, 67 B.R. 990, 999-1000 (Bankr. D. Conn. 1986) (citing both *American Mariner* and *Pine Lake Village*, favorably, and stating that value of secured position as it existed at commencement of case must be protected).
E.D. N.Y.	Sometimes	*In re Island Helicopter, Inc.*, 63 B.R. 809, 816-17 & n.4, 818 (Bankr. E.D. N.Y. 1986) (no lost opportunity costs where no prepetition foreclosure has begun; such compensation "would appear to be warranted" if creditor has commenced foreclosure prepetition).
	Yes	*In re Anchorage Boat Sales, Inc.*, 4 B.R. 635, 641-44 (Bankr. E.D. N.Y. 1984) (pre-*American Mariner*).
S.D. N.Y.	Probably not	*In re Manville Forest Products Corp.*, 43 B.R. 293, 302 & n.7 (Bankr. S.D. N.Y. 1984) (referring in dicta to "expansive holding" of *American Mariner* and citing *South Village* with approval); *In re XB-1 Associates*, 27 B.R. 827, 834 (Bankr. S.D. N.Y. 1983) (pre-*American Mariner*; cites *South Village* favorably).
	No	*In re Saypol*, 31 B.R. 796, 799-802 (Bankr. S.D. N.Y. 1983) (pre-*American Mariner*); *In re Pine Lake Village Apartment Co.*, 19 B.R. 819, 826-28 (Bankr. S.D. N.Y. 1982) (pre-*American Mariner*).

3rd Circuit	No decision	
E.D. Pa.	No	*In re Grant Broadcasting of Philadelphia, Inc.*, No. 86-05614S, Lexis slip op. at 14-15 (Bankr. E.D. Pa. Mar. 2, 1987) (following *Timbers*); *In re Fries*, No. 86-01193 G, slip op. at 11-14 (Bankr. E.D. Pa. Dec. 29, 1986); *In re Small*, 65 B.R. 686 (Bankr. E.D. Pa. 1986).
	Probably	*In re Nesmith*, 57 B.R. 348, 349 (Bankr. E.D. Pa. 1986) (stating in dicta that court "draws succor" from *American Mariner*).
D.N.J.	Unclear	*In re Dunes Casino Hotel*, No. 85-04270, Lexis slip op. at 10-12 (Bankr. D.N.J. Dec. 31, 1986) (finding equity cushion; cites *American Mariner* and *Briggs* without citing *Timbers*).
D. Del.	Yes	*In re Monroe Park*, 17 B.R. 934, 940 (D. Del. 1982) (pre-*American Mariner*; adopts *Briggs*-like case-by-case approach).
4th Circuit:	Yes	*Grundy Nat'l Bank v. Tandem Mining Corp.*, 754 F.2d 1436, 1441 (4th Cir. 1985) (following *American Mariner*). *But see In re Penny*, 52 B.R. 816, 820-21 (Bankr. E.D. N.C. 1985) (while purporting to be bound by *Grundy*, no compensation for time value awarded because of evidence that delay in marketing property would increase value of collateral).
5th Circuit:	No	*In re Timbers of Inwood Forest Associates, Ltd.*, 793 F.2d 1380 (5th Cir.), reh'g *en banc granted*, 802 F.2d 777 (5th Cir.) (*en banc*), *aff'd*, 808 F.2d 363 (5th Cir. 1986) (*en banc*).

6th Circuit:	No decision	
N.D. Ohio	Yes	*In re Mary Harpley Builders, Inc.*, 44 B.R. 151, 155-56 (Bankr. N.D. Ohio 1984) (noting conflict and choosing to follow *American Mariner*).
	No	*In re Shriver*, 33 B.R. 176, 182 (Bankr. N.D. Ohio 1983) (pre-*American Mariner*).
S.D. Ohio	No	*In re The Cablehouse*, 68 B.R. 309, 311-12 (Bankr. S.D. Ohio 1986) (following *Timbers*); *In re Pullins*, 65 B.R. 560, 562-63 (Bankr. S.D. Ohio 1986) (following *Timbers*).
E.D. Mich.	Yes	*In re Roberts*, No. 86-09112, Lexis slip op. at 3-4 (Bankr. E.D. Mich. Oct. 15, 1986) (following *American Mariner*); *In re Independence Village, Inc.*, 52 B.R. 715, 727-29 (Bankr. E.D. Mich. 1985) (following *American Mariner*); *In re Vanas*, 50 B.R. 988, 998-99 (Bankr. E.D. Mich. 1985) (following *American Mariner*).
	Unclear	*In re Churchfield*, 66 B.R. 30, 32 (Bankr. E.D. Mich. 1986) (citing *Timbers* favorably in dicta).
E.D. Wisc.	Yes	*In re Weyland*, No. 86-00908, slip op. (Bankr. E.D. Wisc. July 31, 1986) (rejecting *Briggs*).
W.D. Wisc.	Probably	*In re Topper*, 52 B.R. 94, 95-96 & n. 4 (Bankr. W.D. Wisc. 1985) (stating in dicta that it is "not clear why the marginally over-secured creditor should be able to obtain relief from stay for failure to service debt while the marginally undersecured creditor cannot").

E.D. Tenn.	Probably not	*In re Concorde Limited Partnership*, 67 B.R. 717, 723-24 (Bankr. E.D. Tenn. 1986) (lost opportunity costs "should rarely be required, if ever").
7th Circuit:	No decision	
N.D. Ill.	Probably	*In re 666 Associates/Streetville Utility Co.*, 65 B.R. 919, 923 (N.D. Ill. 1986) (noting effect of passage of time on creditor's security and disapproving *Alyucan*).
	Unclear	*Matter of Langley*, 30 B.R. 595, 601-02 & n. 5, 604-05 (Bankr. N.D. Ill. 1983) (pre-*American Mariner;* cites *Pine Lake Village* for proposition that adequate protection is limited to decline in value of collateral, but refers to "flexible concept" of adequate protection permitting post-petition interest).
	Yes	*In re Levine*, 45 B.R. 333, 338 & n. 8 (N.D. Ill. 1984) (approving *American Mariner*); *In re EES Lambert Associates*, 62 B.R. 328, 343 (Bankr. N.D. Ill. 1986) (use of cash collateral; unclear whether court follows *American Mariner* or *Briggs*); *Matter of Lipply*, 56 B.R. 524, 526 (Bankr. N.D. Ill. 1986) (following *American Mariner*).
S.D. Ill.	Yes	*In re Leavell*, 56 B.R. 11, 13 (Bankr. S.D. Ill. 1985) (following *American Mariner*).
N.D. Ind.	Yes	*Matter of Deeter*, 53 B.R. 623, 626-29 (Bankr. N.D. Ind. 1985) (following *American Mariner*).
8th Circuit:	Depends	*In re Briggs Transportation Co.*, 780 F.2d 1339 (8th Cir. 1985)

		(bankruptcy court has discretion to award lost opportunity costs if appropriate under circumstances). *See also In re Ahlers,* 794 F.2d 388, 394-95 (8th Cir. 1986) (reaffirming *Briggs*).
9th Circuit:	Yes	*In re American Mariner Industries, Inc.,* 734 F.2d 426 (9th Cir. 1984).
10th Circuit:	No decision	
D. Colo.	Probably	*In re Johnson,* 63 B.R. 550, 553 (Bankr. D. Colo. 1986) (stating in dicta that "we are concerned here with the problem of protecting the secured creditor's interest in the collateral, including the right to foreclose and realize the cash value of the collateral"; cites *American Mariner* with approval).
	No	*In re Cantrup,* 32 B.R. 1004, 1005 (Bankr. D. Colo. 1983) (pre-*American Mariner*).
D. Utah	No	*In re South Village, Inc.,* 25 B.R. 987 (Bankr. D. Utah 1982) (pre *American Mariner*); *In re Alyucan Interstate Corp.,* 12 B.R. 803, 806-09 (Bankr. D. Utah 1981) (pre-*American Mariner*).
11th Circuit:	No decision	
M.D. Fla.	No	*In re South County Realty,* No. 86-3792, Lexis slip op. at 3-4 (Bankr. M.D. Fla. Jan. 24, 1987) (following *Timbers*); *In re Galvez,* No. 86-2684, Lexis slip op. at 2 (Bankr. M.D. Fla. Dec. 29, 1986) (following *Timbers*); *Matter of Ritz Theatres, Inc.,* 68 B.R. 256, 260 (Bankr. M.D. Fla. 1986) (following *Timbers*).

S.D. Fla.	No	*In re Rich International Airways, Inc.,* 50 Bankr. 17, 18 (Bankr. S.D. Fla. 1985) (adequate protection payments credited against principal, citing *Alyucan;* no mention of *American Mariner*).
N.D. Ga.	Depends	*In re Peach State Distributing Co.,* 58 B.R. 873, 875-76 (Bankr. N.D. Ga. 1986) (following *Briggs*).
N.D. Ala.	Unclear	*In re Digby,* 47 B.R. 614, 623 (Bankr. N.D. Ala. 1985) (because of equity cushion, "there is no problem of 'adequate protection' of the 'time-use' value of the moving party's interest in the property," citing *American Mariner*).

OPPOSITION
BRIEF

Supreme Court, U.S.
FILED
MAY 6 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1602 ②

In The

Supreme Court of the United States

October Term, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS,

Petitioner,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
d/b/a TIMBERS OF INWOOD FOREST
APARTMENTS, PHASE I,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN RESPONSE TO PETITION FOR WRIT OF CERTIORARI

LEONARD H. SIMON
DAPHNE LEVEY
TIMOTHY J. HENDERSON
PENDERGRAFT, ELAM & SIMON
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

21pp

QUESTION PRESENTED

What constitutes adequate protection of the interest of an undersecured creditor under 11 U.S.C. § 362(d)(1).

LIST OF PARTIES

The list of parties submitted by the Petitioner in its Petition for Writ of Certiorari is correct except that W. B. Easter, Arthur C. Morales and Arden D. Christianson are not limited partners of the Respondent, but are guarantors of the note signed by Respondent in favor of the Petitioner.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
LIST OF PARTIES	ii
TABLE OF CONTENTS	iii
TABLE OF AUTHORITIES	iv
OPINIONS BELOW	2
STATEMENT OF THE CASE	2
SUMMARY OF ARGUMENT	3
ARGUMENT	4
CONCLUSION	9
APPENDIX "A"	App. 1
APPENDIX "B"	App. 5

TABLE OF AUTHORITIES

Page

CASES

American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) 4, 7, 8, 9

Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380 (5th Cir. 1986) *reinstated and aff'd en banc* 808 F.2d 363 (5th Cir. 1987) 4, 6, 8

Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946) 3, 8

UNITED STATES STATUTES

11 U.S.C. § 361 5

11 U.S.C. § 362 .... 4, 5, 7

11 U.S.C. § 502 .... 3, 8

11 U.S.C. § 506 .... 3, 8

No. 86-1602

In The

Supreme Court of the United States

October Term, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
d/b/a TIMBERS OF INWOOD FOREST
APARTMENTS, PHASE I,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN RESPONSE TO PETITION FOR WRIT OF CERTIORARI

TO THE HONORABLE, THE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

OPINIONS BELOW

Respondent would like to add to the statement of the Opinions Below submitted by Petitioner the fact that both the United States District Court for the Southern District of Texas and the United States Court of Appeals for the Fifth Circuit (hereinafter referred to as the "Fifth Circuit") issued a stay pending appeal without bond in the case. The order of the District Court for the Southern District of Texas is reprinted as Appendix A, App. 1. The order of the Fifth Circuit is reprinted as Appendix B, App. 5.

STATEMENT OF THE CASE

To the Statement of the Case submitted by Petitioner, Respondent would add the following. Petitioner recites in its Statement of the Case that when a Debtor files a bankruptcy case an "undersecured creditor's only effective remedy is to bring a motion for relief from the automatic stay pursuant to Bankruptcy Code § 362(d), 11 U.S.C § 362(d) . . . ." Petition for Writ of Certiorari p. 4. This statement is unnecessarily narrow. Under the Bankruptcy Code, creditors have many options throughout the course of a Chapter 11 reorganization case, and all of them are intended to be effective solutions to problems affecting the rights of creditors.

Second, Petitioner states that "[b]ecause the Court also found that the market value of the property was less than the debt secured thereby, 49 B.R. at 460, there was nothing to secure the payment of rapidly-accruing interest under the note." Petition for Writ of Certiorari p. 7. This statement ignores a fundamental principle of bankruptcy law, previously announced by this Court in *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946), that an unsecured creditor (or in this case an undersecured creditor) is not allowed, as part of its claim, an accrual of interest during the post-petition period. See 11 U.S.C. §§ 502(b)(2) and 506(b), where such principle is carried forward into the Bankruptcy Code.

Respondent would add to Petitioner's Statement of the Case the fact that since the filing of the reorganization case on March 4, 1985, Respondent has continued to make payments to Petitioner consisting of all excess cash flow (net operating income) over and above ordinary and necessary operating expenses generated by the apartment complex commonly known as Timbers of Inwood Forest Apartments, Phase I (the "Property"), securing the debt of Petitioner. Such payments equal, and very likely could exceed, the amount that Petitioner would receive if it were in possession of the Property.

It is also important to note that both the District Court for the Southern District of Texas and the Fifth Circuit stayed the effect of the lower courts' decisions by issuing stays pending appeal without bond.

SUMMARY OF ARGUMENT

Respondent concurs that there is a split of authority on the question presented. Respondent also concurs with Petitioner that the question presented is an important question of federal law. The question presents two important issues. The first issue involves the question of what the proper balance of rights between debtors and creditors should be during the course of a reorganization case under the Bankruptcy Code. The opposing views in the circuits each espouse a different balance, creating major differences in how the Bankruptcy Code will impact debtor-creditor relationships. The second issue addresses the ever-present concern over judicial legislation. While both views of the circuits present possible policies which could be embodied in the bankruptcy laws, there is little doubt that the view of the Fifth Circuit represents the current policy intent of Congress, as expressed through the Bankruptcy Code and the legislative history attendant thereto.

ARGUMENT

Respondent acknowledges a split of authority on the question presented. The opinion of the United States Court of Appeals for the Ninth Circuit (hereinafter referred to as the "Ninth Circuit") in the *American Mariner* case conflicts directly with the opinion of the Fifth Circuit in *Timbers. Compare In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir 1984) *with In re Timbers of Inwood Forest Associates, Ltd.*, 793 F.2d 1380 (5th Cir. 1986) *reinstated and aff'd en banc* 808 F.2d 363 (5th Cir. 1987). The lower courts are divided on the issue as well.

The automatic stay provided for under 11 U.S.C. § 362(a), statutorily created in 1978 by Congress, is considered one of the most fundamental protections afforded

creditors and debtors under the Bankruptcy Code. Its function is two-fold: first, to prevent the piecemeal dismemberment of the bankruptcy estate by its most diligent creditors; and second, to allow creditors and the debtor sufficient time, free from harrassment, to analyze the assets and business opportunities of the bankruptcy estate and to restructure and reorganize the debtor's business. Congress has consistently promoted reorganizations under the Bankruptcy Code and all prior bankruptcy legislation because a reorganized debtor benefits society and, statistically, provides a greater recovery to creditors than a debtor which is liquidated. To permit the bankruptcy estate to be reorganized rather than leaving it to piecemeal dismantling by its most diligent creditors is, therefore, for the benefit of creditors. The automatic stay provisions of the Bankruptcy Code only derivatively benefit debtors and their interest holders (that is, investors, shareholders and partners), since in most cases asset values stretch only far enough to satisfy the claims of creditors—generally, interest holders' investments can be recovered only after satisfaction of creditor claims.

Thus, the primary emphasis of the bankruptcy laws is to maximize the return to each creditor through a system intended to be fair to all creditors. The price each creditor pays to gain this benefit is a delay in enforcement of its legal rights and satisfaction of its claims. Although Congress did not intend to provide creditors compensation for such delay, it did recognize that such delay could be imposed only if certain of the debtor's creditors were provided with adequate protection during the reorganization process. The concept of adequate protection is embodied in 11 U.S.C. § 362(d)(1), and is illustrated in 11 U.S.C. § 361.

Congress recognized that those creditors having an interest in property owned by the debtor, such as a secured creditor having a lien on property owned by the debtor, would be entitled to adequate protection during the period necessary to complete the reorganization, because it was possible, for example, for such secured creditor's collateral to depreciate or be consumed. That is, adequate protection was intended to ensure that the secured creditor would be able to look to property of the same value at the time of plan confirmation as that which secured its claim at the commencement of the reorganization case. Again, Congress never intended to compensate creditors for delay through the vehicle of adequate protection during the period prior to plan confirmation.

The automatic stay and the form and magnitude of adequate protection are the competing ends which the courts below have attempted to balance. They are fundamental concepts intended to deal on an interim basis with the relationship between debtor and creditor pending the filing and confirmation of the plan of reorganization.

The question of what constitutes adequate protection for an undersecured creditor is a pivotal one in the Bankruptcy Code. If, as enunciated by the Fifth Circuit in the *Timbers* case, adequate protection is intended to protect an undersecured creditor's right to have its collateral value preserved, then undersecured creditors will be basically in the same position as other creditors of the bankruptcy estate. They will share not only the burdens and risks of delay, but also the benefits of a successful reorganization. Undersecured creditors will have the same range of statutory protections for delay and the same incentives as other creditors to work towards a successful plan of reorganization. Their focus will be on the contents of the plan of reorganization and the final fixing of rights resulting therefrom, rather than forcing such complex decisions thirty to sixty (30-60) days after commencement of a Chapter 11 reorganization case through a summary § 362(d) hearing conducted on the issue of whether the automatic stay should be lifted.

If, on the other hand, an undersecured creditor is entitled not only to protection against depreciation of its collateral value but also compensation for the delay itself, a policy adopted by the Ninth Circuit in *American Mariner*, then an undersecured creditor will become essentially a non-party to the reorganization. Its rights will be established promptly after the commencement of the case to the detriment of other creditors who have not had the opportunity to organize, express their views to the bankruptcy court, and protect their rights.

Furthermore, the *American Mariner* view fails to account for the relative bargaining positions of the parties at the inception and during the course of their relationship. The undersecured creditor could have ensured that it would receive post-petition interest during the course of the Chapter 11 reorganization case simply by having bargained for additional collateral at the time the loan was negotiated and entered. Likewise, the unsecured creditor could have bargained for collateral but did not. Having failed to do so, and thereby having adopted a riskier course of action, the undersecured creditor, just as in the case of the unsecured creditor, should not be permitted to benefit from its bad business decision by receiving what in essence amounts to interest payments on the unsecured deficiency portion of its claim. This result works to the detriment of other unsecured creditors who must fund the *American Mariner* payments from unencumbered assets to which they otherwise would be entitled to look for payment of their claims. Moreover, the policy adopted by the Ninth Circuit in the *American Mariner* case is directly in conflict with §§ 502(b)(2) and 506(b) of the Bankruptcy Code and this Court's prior decision in *Vanston Bondholders*.

Stripped, then, of its clever but fanciful interpretation of the adequate protection provisions of the Bankruptcy Code and the attendant legislative history, the *American Mariner* case is nothing more than an attempt to undermine well-established, long-standing concepts in bankruptcy law intended to (i) prevent piecemeal dismemberment of a bankruptcy estate by the diligent creditors' "race to the courthouse", (ii) provide a period of relative calm, free of harrassment, during which creditors and the debtor can analyze the assets and business prospects of the debtor and work towards a reorganization intended to maximize the benefits for all creditors, and (iii) prevent payment of interest on unsecured or undersecured claims. If the approach taken by the Ninth Circuit prevails, the Bankruptcy Code will lose much of its force.

The *Timbers* case is a scholarly, thoroughly-researched analysis of the question of what constitutes adequate protection under the Bankruptcy Code. It is difficult to deny that the opinion does not definitively outline the law in this area, especially when compared with the perfunctory analysis of the Ninth Circuit in the *American Mariner* case. Petitioner and all others who espouse the *American Mariner* view are making policy arguments based on what the law should be. The Fifth Circuit has clearly demonstrated what the law is. If the *American Mariner* view has indeed come of age, then it should be within the province of Congress to enact such changes and not the judiciary.

CONCLUSION

WHEREFORE, TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Respondent, prays that a writ of certiorari issue from this Honorable Court to affirm the judgment of the United States Court of Appeals for the Fifth Circuit in *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.* In the event that the Petition is granted, Respondent prays that oral argument be allowed and that the judgment of the Court below be affirmed in all respects.

Respectfully submitted this 4th day of May, 1987.

Leonard H. Simon
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

Attorney for Respondent

Of Counsel:

Daphne Levey
Timothy J. Henderson
Pendergraft, Elam & Simon
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

APPENDIX A

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:	§	
	§	
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Debtor	§	
	§	
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Appellant	§	
	§	CIVIL ACTION NO. H-85-4529
VS.	§	
	§	
UNITED SAVINGS ASSOCIATION OF TEXAS, Appellee and Cross-Appellant	§	BKCY. No. 85-01453-H3-5
	§	
VS.	§	
	§	
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., Cross-Appellee	§	

MEMORANDUM AND ORDER

(Filed Sept. 9, 1985)

Pending before the Court is Appellant's Motion For Stay Pending Appeal Without Bond. Having considered the briefs of counsel, the facts, and the law, the Court is of the opinion that the Motion should be granted.

This case is on appeal from the decision of the Bankruptcy Court taken pursuant to 28 U.S.C. § 158. This motion for stay is made pursuant to Bankruptcy Rule 8005.

Appellant is a Texas limited partnership involved in the business of operating a multi-family apartment rental project located in Houston, Texas. Appellant filed its voluntary petition under Chapter 11 of the Bankruptcy Code on March 4, 1985, and continues in possession of its property as a debtor in possession Appellee is the owner and holder of a promissory note in the principal amount of $4,100,000.00. The note is secured by a Deed of Trust and Security Agreement, which creates a lien on Appellant's apartment project. The market value of Appellant's apartment project, however, is considerably less than the principal amount of the note. Appellee is thus an undersecured creditor.

The Appellee asserted in the Bankruptcy Court that for undersecured creditors, the adequate protection provision of the Bankruptcy Code requires compensation for the lost opportunity to foreclose on the collateral and reinvest the proceeds, "lost opportunity cost." *See In re American Mariner Industries, Inc.*, 734 F.2d 1436 (9th Cir. 1985). Appellant, however, argued that Appellee was only entitled to preservation of the value of the collateral, not the "lost opportunity cost." *See In re South Village, Inc*, 8 C.B.C.2d 42 (Bankr.D. Utah 1982). The Bankruptcy Judge, following *In re American Mariner, Inc., supra*, held for the Appellee, awarding it compensation for the "lost opportunity cost," calculated from the point in time when the Appellee could have completed the foreclosure and sale of the property and reinvested the proceeds.

Appellant appeals the decision of the Bankruptcy Court to this Court, arguing that this Court should reject the reasoning in *In re American Mariner, Inc.*, and deny Appellee compensation for the "lost opportunity cost." Appellee cross-appeals, asserting that the Bankruptcy Judge erred in calculating the compensation for the "lost opportunity cost." Appellant has moved for a stay without bond pending the adjudication of the appeal to prevent Appellee from beginning foreclosure proceedings on Appellant's apartment rental project. Time limits for the parties to submit the briefs in the appeal have not yet expired, thus the Court will not consider the merits of the appeal, but will address only the Motion For Stay Pending Appeal Without Bond.

In *Ruiz v. Estelle*, 650 F.2d 555 (5th Cir. 1981), *cert. denied*, 460 U.S. 1042 (1983), the Fifth Circuit set out four elements a court must consider in determining the propriety of a stay pending appeal: First, whether the Appellant has made a showing of likelihood of success on the merits. Second, whether the Appellant has made a showing of irreparable injury if the stay is not granted. Third, whether the granting of the stay would substantially harm the other parties. Fourth, whether the granting of the stay would serve the public interest. *Ruiz*, 650 F.2d at 565.

The main issue in the appeal is whether this Court should adopt the Ninth Circuit's position in *In re American Mariner, Inc., supra.* This is a serious question of law never before confronted in the Fifth Circuit. Because this issue is one of first impression and presents a serious legal question this Court cannot assess Appellant's probability of success on appeal prior to adjudication of the appeal.

The Fifth Circuit has held, however, that when a serious legal question is involved on appeal, the movant need only present a substantial case on the merits to meet the first requirement of a stay. *Ruiz*, 650 F.2d at 565. The Court finds that Appellant has presented a sufficiently substantial case on the merits of this issue to satisfy this burden.

Second, Appellant has shown that without a stay there is a substantial risk that Appellant's apartment project will be foreclosed upon, causing Appellant to lose its primary asset. The Court finds that such a loss would cause Appellant irreparable harm.

Third, the Court anticipates that the appeal in this case can be adjudicated expeditiously upon submission of briefs by the parties. The Court finds that Appellee will not suffer any substantial harm by the relatively short delay occasioned by the adjudication of the appeal.

Fourth, the Court finds that because of the serious legal question involved in this case and because the rights of the parties hinge completely on this question, that a stay would be in the public interest.

THEREFORE, IT IS HEREBY ORDERED THAT APPELLANT'S MOTION FOR STAY WITHOUT BOND PENDING APPEAL BE GRANTED IN ALL RESPECTS.

DONE in Houston, Texas, this 9th day of September, 1985.

/s/ JAMES DeANDA
UNITED STATES DISTRICT
JUDGE

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 85-2678

IN RE: TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Debtors,

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Plaintiff-Appellant
Cross-Appellee,

versus

UNITED SAVINGS ASSOCIATION
OF TEXAS,
Defendant-Appellee
Cross-Appellant,

Appeal from the United States District Court for the
Southern District of Texas

(Filed Oct. 22, 1985)

Before GEE, RANDALL, and DAVIS, Circuit Judges.

BY THE COURT:

IT IS ORDERED that the motion of appellant( ) for stay pending appeal is GRANTED.

IT IS FURTHER ORDERED that the appeal is classified for oral argument and expedited for hearing on Wednesday, November 6, 1985 in the West Courtroom, Rm. 265, of the Fifth Circuit Court of Appeals Courthouse in New Orleans.

JOINT
APPENDIX

Supreme Court, U.S.
FILED
JUL 9 1987
JOSEPH F. SPANIOL, JR.
CLERK

③

No. 86-1602

IN THE
Supreme Court of the United States
OCTOBER TERM, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS
Petitioner,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

JOINT APPENDIX

PETITION FOR CERTIORARI FILED APRIL 3, 1987
CERTIORARI GRANTED MAY 26, 1987

H. MILES COHN*
SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe,
Suite 1700
Houston, Texas 77057
(713) 785-1700
Counsel for Petitioner

LEONARD H. SIMON*
PENDERGRAFT, ELAM &
SIMON
1400 Post Oak Blvd.
Suite 600
Houston, Texas 77056
Counsel for Respondent

* Counsel of Record

TABLE OF CONTENTS

PAGE

Relevant Docket Entries 1

Motion For Relief From Stay, filed March 18, 1985, by United Savings Association of Texas, in the United States Bankruptcy Court for the Southern District of Texas ... 4

Notice of Motion For Relief From Stay, filed March 18, 1985, by United Savings Association of Texas in the Bankruptcy Court 8

Request for Hearing, filed March 27, 1985, by Timbers of Inwood Forest Associates, Ltd., in the Bankruptcy Court 10

Answer to Motion For Relief From Stay, filed April 17, 1985, by Timbers of Inwood Forest Associates, Ltd., in the Bankruptcy Court 12

*Order of the Bankruptcy Court, entered April 19, 1985 .... Appendix G

*Opinion of the Bankruptcy Court, entered May 7, 1985 .... Appendix F

*Order Granting Relief From Stay, entered October 11, 1985, by the United States District Court for the Southern District of Texas .... Appendix E

*Memorandum and Order, entered September 23, 1985, by the District Court .... Appendix D

*Opinion, entered July 9, 1986, by the United States Court of Appeals for the Fifth Circuit, referring hearing to *en banc* Court of Appeals .... Appendix C

*Opinion, entered July 9, 1986, by the Court of Appeals .... Appendix B

**En Banc* Opinion, entered January 9, 1987, of the Court of Appeals .... Appendix A

---

* These Orders and Opinions were previously printed in Petitioner's Petition for Writ of Certiorari, as Appendices A through G thereof.

CHRONOLOGICAL LISTING OF RELEVANT DOCKET ENTRIES

Cause No. 85-01453-H3-5 in the United States Bankruptcy Court for the Southern District of Texas

March 18, 1985	Motion For Relief From Stay filed by United Savings Association of Texas.
March 18, 1985	Notice of Motion For Relief From Stay filed by United Savings Association of Texas.
March 27, 1985	Request for Hearing filed by Timbers of Inwood Forest Associates, Ltd.
April 17, 1985	Preliminary Hearing.
April 17, 1985	Answer to Motion For Relief From Stay.
May 10, 1985	Order Consolidating Preliminary Hearing and Final Hearing; Order signed on April 17, 1985.
May 17, 1985	Motion for Stay Pending Appeal Without Bond filed by Timbers of Inwood Forest Associates, Ltd.
May 20, 1985	Memorandum Opinion entered; Order signed on May 7, 1985.
May 29, 1985	Notice of Appeal filed by Timbers of Inwood Forest Associates, Ltd.
June 6, 1985	Order on Motion For Stay Pending Appeal Without Bond, denied May 17, 1985.
June 6, 1985	Response to Motion For Stay Pending Appeal Without Bond filed by United Savings Association of Texas.

Civil Action No. H-85-4529 in the United States District Court for the Southern District of Texas

August 15, 1985	Brief for Appellant filed by Timbers of Inwood Forest Associates, Ltd.

August 15, 1985	Motion For Stay Pending Appeal Without Bond of Appellant filed by Timbers of Inwood Forest Associates, Ltd.
August 26, 1985	Response to Appellee's Motion For Stay Pending Appeal Without Bond filed by United Savings Association of Texas.
August 30, 1985	Brief for Appellee and Cross-Appellant filed by United Savings Association of Texas.
September 9, 1985	Memorandum and Order entered. Appellant's Motion for Stay Without Bond Pending Appeal granted.
September 23, 1985	Memorandum and Order filed. Ordered that the decision of the Bankruptcy Court be affirmed in all respects and that the stay of the Bankruptcy Court's Order to be Dissolved.
October 3, 1985	Plaintiff's Notice of Appeal from the Order entered September 23, 1985.
October 3, 1985	Motion for Withdrawal of Reference on Motion For Relief From Stay, and for Entry of Order Granting Relief From Stay Pursuant to Previous Order of the Bankruptcy Court, filed by United Savings Association of Texas.

Cause No. 85-2678 in the United States Court of Appeals for the Fifth Circuit

October 21, 1985	Appellant's Motion For Stay Pending Appeal filed by Timbers of Inwood Forest Associates, Ltd.
October 22, 1985	Motion for Stay Pending Appeal Granted. Further ordered that the appeal be expedited, to be heard November 6, 1985.

October 31, 1985	Motion to Modify Court of Appeal's Stay of the District Court's final orders pending appeal, filed by United Savings Association of Texas.
November 1, 1985	Appellant's response to Appellee's Motion to Modify Stay, filed by Timbers of Inwood Forest Associates, Ltd.
November 11, 1985	Order Granting Appellee's Motion to Modify previous order of October 22, 1985. Appellee may post the property for sale in December, January, and February.
February 5, 1986	Motion to Modify Stay Pending Appeal, filed by United Savings Association of Texas.
February 5, 1986	Letter dated February 4, 1986, from Appellee/Cross-Appellant, requesting emergency ruling on Motion to Modify Stay.
February 5, 1986	Order granting Appellee's motion to modify court's previous orders of October 22, 1985 and November 11, 1985.
July 9, 1986	Order referring case to be reheard *en banc*.
September 22, 1986	Orally argued this date before the *en banc* Court.
January 9, 1987	Panel opinion of July 9, 1986, is reinstated.

IN THE

United States Bankruptcy Court

FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:

TIMBERS OF INWOOD FOREST §
ASSOCIATES, LTD.,
Debtor. §

UNITED SAVINGS ASSOCIATION
OF TEXAS, §
Movant,
vs. §

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD., §
Respondent.

Case No. 85-01453-H3-5
(Chapter 11)

MOTION FOR RELIEF FROM STAY OF AN ACT AGAINST PROPERTY

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE:

Comes now United Savings Association of Texas (hereinafter "United Savings"), a savings and loan association organized under the laws of the State of Texas, and moves the Court to terminate the automatic stay as to United Savings in the referenced case, and in support of such motion would respectfully show unto the Court as follows:

I.

Timbers of Inwood Forest Associates, Ltd., the Debtor, filed its voluntary petition under Chapter 11 of the Bankruptcy Code on or about March 4, 1985, thereby initiating the referenced

bankruptcy case. This Court accordingly has jurisdiction to hear this motion pursuant to 28 U.S.C. § 1471.

II.

United Savings is the owner and holder of one certain promissory note (the "Note") dated June 29, 1982, in the original principal amount of $4,100,000.00. A true and correct copy of the Note is attached hereto as Exhibit "A" and incorporated herein by reference. The Note is secured by one certain Deed of Trust and Security Agreement (the "Deed of Trust") also dated June 29, 1982. A true and correct copy of the Deed of Trust is attached hereto as Exhibit "B" and incorporated herein by reference. The Deed of Trust covers certain real property (the "Property) consisting of an apartment project located in Houston, Texas, which Property is commonly known as Timbers of Inwood Forest Apartments.

III.

The Note is in serious default. No payment has been made of any portion of sums due under the Note from August, 1984, to the present. As of March 4, 1985, the date on which the Debtor's petition was filed, accrued unpaid interest was in excess of $300,000, and such interest continues to accrue. Because of the Debtor's default, the principal obligation of the Note has been duly accelerated and is now due and owing. The unpaid principal amount of the Note is $3,929,319.27. This debt continues to grow as interest and other sums rapidly accrue. Nevertheless, no offer has been made by the Debtor to protect the value of United Savings' security interest under the Deed of Trust, nor has any offer been made to secure continually increasing interest.

IV.

The Debtor's default under the Note is the subject of a proceeding pending in state district court, in which United Savings' rights to possession of the property and to foreclosure of the Property are at issue. The suit is styled *United Savings*

Association of Texas, Plaintiff and Counterdefendant v. *Timbers of Inwood Forest Associates, Ltd., Defendant and Counterplaintiff,* Cause No. 85-06274 in the 215th Judicial District Court of Harris County, Texas. After considerable negotiation, the parties agreed to entry of an Order Granting Request for Temporary Injunction. This agreed order barred United Savings from foreclosing under the Deed of Trust in February, 1985, but allowed United Savings to take possession of the Property and collect rentals therefrom in the interim. The agreement does not bar United Savings from foreclosing in March, 1985, or thereafter.

The Debtor filed its counterclaim in the state court action seeking affirmative relief barring United Savings from foreclosing. United Savings negotiated in good faith, and on the basis of the agreement of the parties approved the Court's Order Granting Request for Temporary Injunction. United Savings complied with its agreement and the terms of the order, and refrained from foreclosing in February despite the substantial default of the Debtor. Having requested affirmative relief in the state court proceeding, and having agreed to a compromise order in settlement of this matter, the Debtor should now be held to its agreement and the stay accordingly lifted to allow foreclosure.

V.

The Debtor was formed for the sole purpose of purchasing and operating the Property. The Debtor has no assets other than the Property, and does not operate any regular business other than the Property. The purpose of this bankruptcy proceeding is not to "reorganize" an ongoing business, therefore, but is to speculate on real property at the expense of United Savings. Moreover, the Note is a "non-liability" note, pursuant to the provisions of which United Savings may not seek a judgment against the Debtor for liability under the Note, but may only pursue its security therefor. The continuation of the automatic stay in this bankruptcy proceeding will not further any legitimate goals of

the Bankruptcy Code and accordingly the automatic stay should be terminated as to United Savings.

VI.

The Respondent is hereby notified that unless a hearing is requested within ten days from the date of the issuance of a Notice of Motion for Relief from Stay, relief may be granted without a hearing.

WHEREFORE, PREMISES CONSIDERED, United Savings Association of Texas, Movant, prays that the Court enter an order, in accordance with 11 U.S.C. § 362(d)(1), terminating the automatic stay, as to United Savings for cause, including the failure to provide adequate protection of the Movant's security interest, and providing such other and further relief to which United Savings may show itself justly entitled.

Respectfully submitted,

H. Miles Cohn

Of Counsel:

SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700

Attorneys for United Savings
Association of Texas

IN THE

United States Bankruptcy Court

FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:

TIMBERS OF INWOOD FOREST §
ASSOCIATES, LTD.,
Debtor, §

UNITED SAVINGS ASSOCIATION
OF TEXAS, §
Movant,
vs. §

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD., §
Respondent

Case No. 85-01453-H3-5
(Chapter 11)

NOTICE OF MOTION FOR RELIEF FROM STAY

To the above named Respondent(s):

You are hereby notified that on *March 18, 1985* the movant shown above has filed the attached motion seeking relief from the automatic stay of 11 U.S.C. 362.

> NO HEARING WILL BE HELD ON THIS MOTION UNLESS WITHIN 10 DAYS OF THE DATE OF ISSUANCE OF THIS NOTICE YOU FILE WITH THE COURT AND SERVE UPON THE MOVANT OR HIS ATTORNEY *H. MILES COHN* WHOSE ADDRESS IS *5847 SAN FELIPE, SUITE 1700, HOUSTON, TEXAS 77057*, A WRITTEN REQUEST FOR A HEARING. IF YOU REQUEST A HEARING YOU MUST ALSO ANSWER THE MOTION BY A PLEADING FILED WITH THE COURT AND SERVED ON THE MOVANT AND MOVANT'S COUNSEL PRIOR TO THE TIME OF HEARING.

If you fail to timely request a hearing, fail to obtain a timely hearing, fail to answer as set forth herein, or fail to appear for hearing, the stay may be terminated by operation of law without notice to you.

APRIL 17, 1985 at 9:30 a.m. IN COURTROOM NUMBER 9 IS FIXED AS THE TIME AND PLACE FOR HEARING IF ONE IS REQUESTED BY THE RESPONDENT. NO HEARING WILL BE HELD SOLELY ON THE REQUEST OF THE MOVANT. NO FURTHER NOTICE WILL BE GIVEN BY THE CLERK'S OFFICE OF THIS HEARING DATE.

JOSEPH J. HESTON
Clerk of the Bankruptcy Court

By: ______________________
Deputy Clerk

Date of Issuance: March 18, 1985

IN THE
United States Bankruptcy Court
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., d/b/a TIMBERS OF INWOOD FOREST APARTMENTS, PHASE I, *Debtor*. §

UNITED SAVINGS ASSOCIATION OF TEXAS, *Movant*, §

vs. §

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., *Respondent*. §

§ Case No. 85-01453-H3-5
(Chapter 11)

REQUEST FOR HEARING

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE OF SAID COURT:

COMES NOW, Timbers of Inwood Forest Associates, Ltd., d/b/a Timbers of Inwood Forest Apartments, Phase I, Debtor in the above-captioned case and files this its Request for Hearing with respect to the Emergency Motion to Lift Stay and hereby requests that the Court set a hearing date on this matter.

Respectfully submitted this 27th day of March, 1985.

PENDERGRAFT, ELAM & SIMON

By: ______________________
Leonard H. Simon
1400 Post Oak Boulevard
Suite 600
Houston, Texas 77056
(713) 850-7766
Counsel for Timbers of Inwood Forest Associates, Ltd., d/b/a Timbers of Inwood Forest Apartments, Phase I

CERTIFICATE OF SERVICE

A true and correct copy of the above and foregoing Request for Hearing was served upon the Debtor's Twenty Largest Unsecured Creditors, opposing counsel, H. Miles Cohn, Schlanger, Cook, Cohn, Mills & Grossberg, 5847 San Felipe, Suite 1700, Houston, Texas 77057, and the following interested parties, by United States Mail, First Class, postage prepaid, on this 27th day of March, 1985:

Timbers of Inwood Forest
Association, Ltd.
5850 West Gulf Bank
Houston, Texas 77088

CAM Leasing Company
230 Westcott, Suite 200
Houston, Texas 77007

Daseke, Inc.
One Glendinning Place
Westport, Connecticut 06880

Dorado Corporation
230 Westcott, Suite 200
Houston, Texas 77077

____
LEONARD H. SIMON

IN THE

United States Bankruptcy Court

FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE:

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., d/b/a TIMBERS OF INWOOD FOREST APARTMENTS, PHASE I, *Debtor*. §
UNITED SAVINGS ASSOCIATION OF TEXAS, *Movant*, §
vs. §
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD., *Respondent*. §

Case No. 85-01453-H3-5
(Chapter 11)

ANSWER TO MOTION FOR RELIEF FROM STAY OF AN ACT AGAINST PROPERTY

TO THE HONORABLE UNITED STATES BANKRUPTCY JUDGE OF SAID COURT:

COMES NOW, Timbers of Inwood Forest Associates, Ltd. ("Timbers") and files this its Answer to Motion for Relief From Stay of Act Against Property (the "Motion") filed by United Savings Association of Texas ("United Savings") and would respectfully show unto the Court as follows:

1. Timbers admits the allegations contained in paragraph I of the Motion.

2. Timbers admits all allegations contained in paragraph II of the Motion as the documents attached to the Motion speak for themselves.

3. Timbers denies the allegations contained in the first and second sentences of paragraph III of the Motion. Timbers admits the allegations in the third sentence of paragraph III of the Motion for purposes only of the preliminary and final hearing hereunder. Timbers is without sufficient information either to admit or deny the allegations contained in the fourth sentence of paragraph III of the Motion and for purposes of pleading, denies the allegations. Timbers admits the allegations contained in the fifth sentence of paragraph III of the Motion only for the purposes of either the preliminary or the final hearing on this Motion. Timbers denies the allegations contained in the sixth and seventh sentences of paragraph III of the Motion.

4. Timbers denies all allegations contained in both paragraphs under the heading "IV" in the Motion, since all such allegations are irrelevant to the issues before the Court. Timbers specifically denies that United Savings complied with its agreement and the terms of the Order.

5. Timbers denies all allegations contained in paragraph V of the Motion.

6. Paragraph VI of the Motion contains only legal conclusions which, for purposes of pleading, Timbers denies.

7. The last paragraph of the Motion contains only legal conclusions which, for purposes of pleading, Timbers denies.

Therefore, Timbers of Inwood Forest Associates, Ltd., prays that this Court deny in all respects the Motion for Relief of Stay and an Act Against Property filed by United Savings Association of Texas and for any and such further relief to which it may show itself justly entitled.

Respectfully submitted this 17th day of April, 1985.

PENDERGRAFT, ELAM & SIMON

By ________________________
Leonard H. Simon
Daphne Levey
Timothy J. Henderson
1400 Post Oak Boulevard
Suite 600
Houston, Texas 77056
(713) 850-7766
Counsel for Timbers of Inwood Forest Associates, Ltd.

CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the above and foregoing Answer to Motion for Relief from Stay of an Act Against Property was sent to counsel for United Savings of Texas, H. Miles Cohn, Schlanger, Cook, Cohn, Mills & Grossberg, 5847 San Felipe, Suite 1700, Houston, Texas 77057, by hand-delivery on this 16th day of April, 1985.

____
LEONARD H. SIMON

PETITIONER'S

BRIEF

(5)

Supreme Court, U.S.
FILED
AUG 1 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1602

In The
Supreme Court of the United States
October Term, 1986

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,
v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR PETITIONER

H. Miles Cohn
Schlanger, Cook, Cohn,
Mills & Grossberg
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700

Counsel for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

QUESTION PRESENTED

Bankruptcy Code section 362(d)(1) requires "adequate protection" of a secured creditor's "interest in property" as a condition to the automatic stay, which from the filing of a bankruptcy case stays the creditor from exercising its rights under state law to foreclose on and sell its collateral and reinvest the proceeds. Does this requirement for "adequate protection," which is defined in Bankruptcy Code section 361, include protection for the costs of the delay in enforcing rights under state law (the "lost time value" or "lost opportunity costs") imposed by the automatic stay?

LIST OF PARTIES

The parties to the proceedings below were the Petitioner, United Savings Association of Texas, and the Respondent, Timbers of Inwood Forest Associates, Ltd.

United Savings Association of Texas is a savings and loan association organized under the laws of the State of Texas. Dime Savings Bank of New York, a banking corporation organized under the laws of the State of New York, is a participating lender in the loan made by United Savings Association of Texas to Timbers of Inwood Forest Associates, Ltd., and is therefore a part owner of the promissory note and liens at issue.

Timbers of Inwood Forest Associates, Ltd. is a limited partnership organized under the laws of the State of Texas. The general partners of the partnership are Woody Mann, Jr. and Dorado Corporation; the limited partners of the partnership are W. B. Easter, Arthur C. Morales and Arden D. Christianson.

TABLE OF CONTENTS

Page

OPINIONS BELOW 1

JURISDICTION 1

STATUTES INVOLVED 2

STATEMENT OF THE CASE 3

SUMMARY OF ARGUMENT 7

ARGUMENT

I. BANKRUPTCY CODE SECTIONS 362(d) AND 361 BY THEIR TERMS REQUIRE PROTECTION FOR THE COSTS OF DELAY IMPOSED BY THE AUTOMATIC STAY 12

  A. *The Language of the Statute: "Adequate Protection" and "Indubitable Equivalent"* 13

  B. *The Backdrop: Relief from the Stay Before Enactment of the Bankruptcy Code* 18

  C. *The Legislative History of the Bankruptcy Code* 24

II. THE SECURED CREDITOR IN A BANKRUPTCY CASE IS ENTITLED TO THE VALUE OF ITS NON-BANKRUPTCY RIGHTS IN PROPERTY, AND THIS REQUIRES PROTECTION FOR THE COSTS OF DELAY, IMPOSED BY THE AUTOMATIC STAY, IN THE EXERCISE OF THOSE RIGHTS 28

III. PROTECTION FOR THE COSTS OF DELAY IMPOSED ON THE SECURED CREDITOR BY THE AUTOMATIC STAY IS CONSISTENT WITH THE INTEREST PROVISIONS OF THE BANKRUPTCY CODE 36

  A. *Protection for the Costs of Delay, Even When Provided by Periodic Post-Petition Payments, Does not Constitute Interest on the Creditor's Allowed Claim* 36

TABLE OF CONTENTS—Continued

Page

B. *The Interest Provisions of the Bankruptcy Code Allow the Secured Creditor to Recover Post-Protection Interest to the Extent that the Creditor Receives Periodic Post-Petition Payments or Other Protection for the Costs of Delay* 38

CONCLUSION: PROTECTION FOR THE COSTS OF DELAY AND THE POLICIES OF THE BANKRUPTCY CODE 47

TABLE OF AUTHORITIES

Page

CONSTITUTION

U.S. Const., art I, § 8, cl. 4 33

CASES

3-C Oil Company vs. Modesta Partnership, 668 S.W.2d 741 (Tex. Civ. App.—Austin 1984, writ ref. n.r.e.) 31

American Iron & Steel Manufacturing Company vs. Seaboard Air Line Railway, 233 U.S. 261, 58 L.Ed 949, 34 S. Ct. 502 (1914) 39

In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) 5, 15

Atkins vs. United States, 556 F.2d 1028 (Ct. Cl. 1977), *cert. denied*, 434 U.S. 1009, 54 L.Ed. 751, 98 S. Ct. 718 (1978) 44

Barron vs. San Angelo National Bank, 138 S.W. 142 (Tex. Civ. App.—Austin 1911, writ ref.) 32

In re Bateman Financial Corp., 5 C.B.C. 488 (Bkrpcy. N.D. Fla. 1975) 22

Beecher vs. Leavenworth State Bank, 192 F.2d 10 (9th Cir. 1951) 41

In re Bermec Corporation, 445 F.2d 367 (2nd Cir. 1971) 23, 25

Birmingham Trust National Bank vs. Case, 755 F.2d 1474 (11th Cir. 1985) 44

In re Black Ranches, Inc., 362 F.2d 8 (8th Cir. 1966) 41

In re Bric of America, Inc., 4 C.B.C. 34 (Bkrpcy. M.D. Fla. 1975) 19

TABLE OF AUTHORITIES—Continued

	Page
In re Briggs Transportation Co., 780 F.2d 1339 (8th Cir. 1985)	5
Butner vs. United States, 440 U.S. 48, 59 L.Ed. 2d 136, 99 S. Ct. 914 (1979)	30, 33
Cannon vs. University of Chicago, 441 U.S. 677, 60 L.Ed. 2d 560, 99 S.Ct. 1946 (1979)	14
Case vs. Los Angeles Lumber Products Co., 308 U.S. 106, 84 L. Ed. 110, 60 S. Ct. 1 (1939)	14
In re Castle Village Company, 13 C.B.C. 452 (Bkrpcy. S.D.N.Y. 1977)	21
Chattanooga State Bank vs. Citizens State Bank, 134 P. 954 (Okl. S. Ct. 1913)	32
City of New York vs. Saper, 336 U.S. 328, 93 L.Ed. 710, 69 S. Ct. 554 (1949)	41
Coder vs. Arts, 152 F. 943 (8th Cir. 1907) *aff'd*, 213 U.S. 223, 53 L.Ed. 772, 29 S. Ct. 436 (1909)	41
Consolidated Rock Products Company vs. DuBois, 312 U.S. 510, 85 L.Ed. 982, 61 S. Ct. 675 (1941)	41
Finberg vs. Sullivan, 461 F. Supp. 253 (E.D. Pa. 1978), *vacated on other grounds*, 634 F.2d 50 (3rd Cir. 1980)	14
First Evangelical Lutheran Church of Glendale vs. County of Los Angeles, 55 U.S.L.W. 4781 (1987)	32
In re Groundhog Mountain Corp., 1 C.B.C. 923 (Bkrpcy. S.D.N.Y. 1975)	19, 22
Group of Institutional Investors vs. Chicago, Milwaukee, St. Paul and Pacific Railway Company, 318 U.S. 523, 87 L.Ed. 959, 63 S. Ct. 727 (1943)	40
Grundy National Bank vs. Tandem Mining Corp., 754 F.2d 1436 (4th Cir. 1985)	5

TABLE OF AUTHORITIES—Continued

	Page
In re Hamilton Mortgage Corp., 13 C.B.C. 77 (Bkrpcy. E.D. Tenn. 1977)	19, 21
In re Hartsdale Associates, 11 C.B.C. 87 (Bkrpcy. S.D.N.Y. 1976)	22
In re Jennifer Mall Corp., 2 C.B.C. 657 (Bkrpcy. D. C. 1974)	19, 22
Kaplan vs. Anderson, 256 F.2d 416 (5th Cir. 1958)	19
Klein vs. Tabatchnik, 610 F.2d 1043 (2nd Cir. 1979)	31
Klingert vs. Fulton Storage and Mercantile Co., 89 N.W. 507 (Wis. S. Ct. 1902)	32
In re Lax Enterprises, 11 C.B.C. 628 (Bkrpcy. N.D. Ohio 1976)	22
In re Leeds Homes, Inc., 222 F. Supp. 20 (E.D. Tenn. 1963), *aff'd*, 332 F.2d 648 (6th Cir. 1964)	42
Littleton v. Kincaid, 179 F.2d 386 (4th Cir. 1950)	41
In re Macomb Trailer Coach, Inc., 200 F.2d 611 (6th Cir. 1952), *cert. den'd sub nom McInnis vs. Weeks*, 345 U.S. 958, 97 L.Ed 1378, 73 S. Ct. 940 (1953)	41, 46
In re Magnum Harmonica Corporation, 262 F.2d 515 (3rd Cir. 1959)	42
Massachusetts vs. Thompson, 190 F.2d 10 (1st Cir. 1951), *cert. den'd*, 342 U.S. 918, 96 L.Ed. 686, 72 S. Ct. 364 (1952)	40
In re Murel Holding Corp., 75 F.2d 941 (2nd Cir. 1935)	14, 15
In re Nevada Towers Associates, 14 C.B.C. 146 (Bkrpcy. S.D.N.Y. 1977)	21

Page

Norwest Bank Worthington and Federal Land Bank of St. Paul vs. Ahlers, 794 F. 2d 388 (8th Cir. 1986), *cert. granted*, no. 86-958 37

In re O.K. Motels, 1 C.B.C. 416 (Bkrpcy. N.D. Fla. 1974) 22

In re Overmyer Company, Inc., 10 C.B.C. 389 (Bkrpcy. S.D.N.Y. 1976) 22

Peoples Homestead Association vs. Bartlette, 33 F.2d 561 (5th Cir. 1929) 41

In re Plaza Towers, Inc., 294 F. Supp. 714 (D.C. E.D. La. 1967) 21

Reconstruction Finance Corp. vs. Kaplan, 185 F.2d 791 (1st Cir. 1950) 21

Sexton vs. Dreyfus, 219 U.S. 339, 55 L.Ed. 244, 31 S. Ct. 256 (1913) 41, 45, 46, 47

In re Sixth Avenue Investment and Development Company, 2 B.C.D. 1222 (Bkrpcy. S.D. Cal. 1976) 22

Superior Construction Co. vs. Elmo, 102 A.2d 739 (M.D. Ct. App. 1954) 31

Surety Savings and Loan Association vs. National Automobile and Casualty Insurance Co., 87 Cal. Reptr. 572 (Cal. App. 1970) 32

In re United Merchants and Manufacturers, Inc., 674 F.2d 134 (2nd Cir. 1982) 42

United States vs. Edens, 189 F.2d 876 (4th Cir. 1951), *aff'd per curiam*, 342 U.S. 912, 96 L.Ed. 682, 72 S. Ct. 357 (1952) 40

United States vs. General Engineering and Manufacturing Company, 188 F. 2d 80 (8th Cir. 1951), *aff'd per curiam*, 342 U.S. 912, 96 L.Ed. 682, 72 S. Ct. 358 (1952) 40

Page

United States vs. Security Industrial Bank, 459 U.S. 70, 74 L.Ed. 2d 235, 103 S. Ct. 407 (1982) 33

United States v. Whiting Pools, Inc., 462 U.S. 198, 76 L.Ed. 2d 515, 103 S. Ct. 2302 (1983) 34, 35

Vanston Bondholders Protective Committee vs. Green, 329 U.S. 156, 91 L.Ed. 162, 67 S. Ct. 237 (1946) 39, 40, 41

In re Yale Express System, Inc., 370 F.2d 433 (2nd Cir. 1966) and 384 F.2d 990 (2nd Cir. 1967) 23, 25, 26

UNITED STATES STATUTES

Bankruptcy Act of 1898 (repealed 1978)

11 U.S.C. § 63 14

11 U.S.C. § 63(a) 38, 39

11 U.S.C. § 63(a)(1) 38

11 U.S.C. § 77B(b)(4) 13

11 U.S.C. § 77B(b)(5) 13

11 U.S.C. § 77B(f) 14

11 U.S.C. § 93(h) 45

11 U.S.C. § 103(a) 38

11 U.S.C. § 106(1) 14, 38

11 U.S.C. § 307(2) 38

11 U.S.C. § 406(2) 14, 38

11 U.S.C. § 506(1) 14, 39

11 U.S.C. § 616(7) 13

11 U.S.C. § 616(8) 13

Page

11 U.S.C. § 708(2) 39

11 U.S.C. § 860(2) 14, 39

11 U.S.C. § 861(11) 13

Bankruptcy Code (enacted 1978)

11 U.S.C. § 361 .... *passim*

11 U.S.C. § 361(1) 9, 17, 28, 36, 37

11 U.S.C. § 361(2) 17, 28, 36

11 U.S.C. § 361(3) 15, 16, 17, 28, 36

11 U.S.C. § 362(a) 3, 4, 7, 12

11 U.S.C. § 362(c) 7

11 U.S.C. § 362(d) .... *passim*

11 U.S.C. § 362(d)(1) 2, 7, 8, 13, 28

11 U.S.C. § 363 5

11 U.S.C. § 365(d)(3) 45

11 U.S.C. § 502(b)(2) 9, 12, 38, 39, 40

11 U.S.C. § 503(b) 45

11 U.S.C. § 506 .... 12, 42

11 U.S.C. § 506(a) 42, 43

11 U.S.C. § 506(b) 43, 44

11 U.S.C. § 542 34

11 U.C.S. § 1104 49

11 U.S.C. § 1112(b)(3) 48

11 U.S.C. § 1121(c) 49

11 U.S.C. § 1129(b)(2)(A) 9, 16, 17, 18, 29

Page

11 U.S.C. § 1129(b)(2)(A)(iii) 15

11 U.S.C. § 1205 29

11 U.S.C. § 1205(b) 29, 30

Other Statutes

28 U.S.C. § 157(a) 3

28 U.S.C. § 158(d) 6

28 U.S.C. § 1254(a) 2

28 U.S.C. § 1334(a) 3

HOUSE & SENATE REPORTS

H. R. Rep. No. 595, 95th Cong., 1st Sess. (1977) 16, 17, 26, 42

S. Rep. No. 989, 95th Cong., 2nd Sess. (1978) 16, 17, 26, 29, 39, 42

Congressional Record S5558 (May 7, 1986) 30

Congressional Record H8999 (October 2, 1986) 30

ARTICLES AND OTHER AUTHORITIES

Baird and Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CH. L. REV. 97 (1984) 30

Black's Law Dictionary 729 (5th ed. 1979) 36

Black's Law Dictionary 1166 (5th ed. 1979) 36

2 W. Blackstone, *Commentaries on the Laws of England* 488 40

3 COLLIER ON BANKRUPTCY (15th ed.) ¶ 502.02 39

Page

3A COLLIER ON BANKRUPTCY (14th ed.) ¶ 16.16 ..... 39, 40

6 COLLIER ON BANKRUPTCY (14th ed.) ¶ 9.05 39

6A COLLIER ON BANKRUPTCY (14th ed.) ¶ 10.12 14

2 Cowans, BANKRUPTCY LAW AND PRACTICE (1968 ed.) § 12.15 45

25 C.J.S. *Damages* § 41 31

25 C.J.S. *Damages* § 84 31

43A C.J.S. *Injunctions* §§ 335-36 32

89 C.J.S. *Trover and Conversion* § 171-72 31

V. Countryman, *Real Estate Liens in Business Rehabilitation Cases,* 50 AM. BANKR. L.J. 303 (1976) 20

C. Fortgang and L. King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions,* 56 N.Y.U.L. REV. 1148 (Nov.-Dec. 1981) 42

F. Kennedy, *The Automatic Stay in Bankruptcy,* 11 U. MICH. J.L. REF. 177 (1978) 19, 20

Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy,* 50 U. CHI. L. REV. 305 (1983) 14

L. Peitzman and M. Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stay in Bankruptcy Proceedings,* 65 CAL. L. REV. 1216 (1977) 19, 20

Page

J. S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause,* 96 HARV. L. REV. 973 (March, 1983) 33

G. Webster, *Collateral Control Decisions in Chapter Cases: Clear Rules vs. Judicial Discretion,* 51 AM. BANKR. L. J. 197 (1977) 19

OPINIONS BELOW

The January 9, 1987, opinion of the Court of Appeals for the Fifth Circuit is reported at 808 F.2d 363. This opinion of the court of appeals, sitting *en banc*, is reprinted as Appendix A to the Petition for Writ of Certiorari (the "Petition") at 1a.

The *en banc* opinion reinstates the prior opinion of a panel of the court of appeals, dated July 9, 1986, which is reported at 793 F.2d 1380. The panel opinion is reprinted as Appendix B to the Petition, at 53a. The opinion of the court of appeals ordering the case to be reheard *en banc*, also dated July 9, 1986, is printed as Appendix C to the Petition, at 134a.

The Memorandum and Order of the District Court for the Southern District of Texas, from which an appeal was taken by the Respondent to the court of appeals, is not published. The Memorandum and Order, dated September 23, 1985, is printed as Appendix D to the Petition, at 136a. The district court also entered an Order Granting Relief from Stay; this unpublished Order, dated October 11, 1985, is printed as Appendix E to the Petition, at 139a.

The opinion of the Bankruptcy Court for the Southern District of Texas, from which an appeal was taken by the Respondent to the district court, is published at 49 B.R. 454. The opinion, dated May 7, 1985, is reprinted as Appendix F to the Petition, at 142a. The bankruptcy court's Order, which required the adequate protection payments at issue in this case, is unpublished. The Order, dated April 19, 1985, is printed as Appendix G to the Petition, at 157a.

JURISDICTION

The judgment of the Court of Appeals for the Fifth Circuit, sitting *en banc*, was entered on January 9, 1987.

The Petition for Writ of Certiorari in this case was filed on April 3, 1987, and was granted on May 26, 1987. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTES INVOLVED

This case involves a motion for relief from the automatic stay of an act against property, filed pursuant to Bankruptcy Code section 362(d)(1), 11 U.S.C. § 362(d)(1). This statute provides:

> *11 U.S.C. § 362(d)(1)*
>
> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest. . . .

Examples of "adequate protection" are listed in Bankruptcy Code section 361, 11 U.S.C. § 361, which provides:

> *11 U.S.C. § 361*
>
> When adequate protection is required under sections 362, 363, or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—
>
> (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property.
>
> (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or

> (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

STATEMENT OF THE CASE

The Petitioner, United Savings Association of Texas ("United Savings"), is the holder of a promissory note executed by the Respondent, Timbers of Inwood Forest Associates, Ltd. ("Timbers"), in the original principal amount of $4,100,000; the note is secured by a first lien deed of trust covering Timbers of Inwood Forest Apartments, Phase I, an apartment project located in Houston, Texas. Following Timbers' default under the note, United Savings posted the property for foreclosure sale, under the deed of trust, for March 5, 1985. Timbers filed its petition under Chapter 11 of the Bankruptcy Code on March 4, the day before the posted foreclosure. Pursuant to Bankruptcy Code section 362 (a), 11 U.S.C. § 362(a), United Savings was automatically stayed from holding the foreclosure sale or otherwise enforcing its rights under the deed of trust.

On March 18, 1985, United Savings filed a motion for relief from the automatic stay, pursuant to Bankruptcy Code section 362(d)(1), 11 U.S.C. § 362(d)(1). Joint Appendix (hereinafter "J.A.") 4. The bankruptcy court had jurisdiction to hear this motion pursuant to 28 U.S.C. § 1334(a) and 28 U.S.C. § 157(a). An evidentiary hearing was held on April 17, but the facts were largely undisputed. As the bankruptcy court found, 49 B.R. at 459, 460-461, Appendix to Petition (hereinafter "App.") F at 151a, 155a, Timbers' obligation to United Savings was in serious default. Accrued unpaid interest exceeded $430,000 at the time of the hearing, and was continuing to rise at a rapid rate. Because the principal balance of the note exceeded $3,900,000, the total debt exceeded $4,360,000 at the hearing.

At the time of the hearing in bankruptcy court, it was undisputed that the note had been in default for over one year, with no attempt having been made to pay accruing interest or other sums. It was also undisputed that this continually-accruing interest could not be secured by any similar increase in the value of the property. While expert appraisers testifying at the hearing both stated that the value of the property would appreciate in the future, neither foresaw any rapid or significant appreciation in the near future. The bankruptcy court concluded that "the value of the collateral is stable, *perhaps* slightly (but *very* slightly) appreciating." 49 B.R. at 456, App. F at 144a. Because the court also found that the market value of the property was less than the debt secured thereby, 49 B.R. at 460, App. F at 155a, there was nothing to secure the payment of rapidly-accruing interest under the note.

Under the deed of trust and applicable state law, United Savings is entitled to have the property securing its debt sold at foreclosure sale, to recover the proceeds of such sale and to reinvest those proceeds. The automatic stay of Bankruptcy Code section 362(a) prevented United Savings from exercising its rights under state law, and thereby deprived it of the income that could have been earned on the reinvested proceeds. The bankruptcy court found that had United Savings been allowed to foreclose and reinvest the collateral proceeds, it could have reinvested the sum of $4,250,000, earning interest at the rate of 12% per annum beginning six months after the foreclosure; but for the automatic stay, therefore, United Savings could have earned $42,500 per month beginning in September, 1985. 49 B.R. at 460-61, App. F at 155a. This lost income is the cost of delay imposed by the automatic stay. The lost income measures the "time value" of United Savings' right under the deed of trust to foreclose *upon default;* it is the same loss that some have labeled "the lost opportunity cost" imposed by the automatic stay.

Following the decision of the Court of Appeals for the Ninth Circuit in *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984),[1] the bankruptcy court held that United Savings' right under state law to foreclose upon default has " 'substantial, measurable value.' " 49 B.R. at 456-57 App. F. at 146a, and that this right is entitled to adequate protection. In order to protect this valuable right, the bankruptcy court conditioned the automatic stay on the monthly payment of a sum equal to the income lost to United Savings as a result of the stay. The bankruptcy court ordered Timbers to commence monthly payments, begining six months after the filing of the bankruptcy case, in the amount of $42,500; the court allowed Timbers to use rents of the property (United Savings' cash collateral under Bankruptcy Code section 363, 11 U.S.C. § 363) to make these payments, but held that the automatic stay would terminate if the payments were not made. App. G.

---

[1] The *American Mariner* holding has since been adopted by the Court of Appeals for the Fourth Circuit, *Grundy National Bank vs. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985), and has been followed in part by the Court of Appeals for the Eighth Circuit, *In re Briggs Transportation Co.*, 780 F.2d 1339 (8th Cir. 1985) (holding that whether the time value of the secured creditor's rights may be entitled to protection is a determination to be made by the bankruptcy court on a "case-by-case" basis).

Following the entry of the bankruptcy court's Order on United Savings' motion for relief from stay, Timbers perfected an appeal to the United States District Court for the Southern District of Texas.[2] On September 23, 1985, the district court entered its Memorandum and Order affirming the Order of the bankruptcy court. App. D. Because Timbers had defaulted under the bankruptcy court's Order, by not making the adequate protection payments required to begin in September, 1985, the district court also entered an Order, dated October 11, 1985, terminating the automatic stay. App. E.

Following the district court's orders affirming the bankruptcy court and terminating the automatic stay, Timbers perfected an appeal to the United States Court of Appeals for the Fifth Circuit.[3] The appeal was originally heard by a three-judge panel. The panel opinion of the court of appeals, issued on July 9, 1986, reversed the orders of the bankruptcy and district courts insofar as they required monthly payments, and remanded for further proceedings. App. B. The court concluded, contrary to the bankruptcy and district courts and contrary to prior decisions of the Ninth, Fourth and Eighth Circuits, that United Savings was not entitled to "periodic post-petition interest payments . . . to compensate it for the delay of the reorganization proceeding during the pendency of the automatic stay." 793 F.2d at 1416, App. B at 133a. In the panel's view, Congress intended that a secured creditor be adequately protected only for the fixed amount of its "allowed secured claim," an amount that is strictly limited to the value of the physical property securing the debt. 793 F.2d at 1385-87, 1399-1400, 1413, 1416, App. B at 62a-68a, 94a-97a, 127a, 133a.

On the same day the panel opinion was issued, the court of appeals vacated the opinion and set the case for rehearing *en banc*. App. C. The sharply divided opinion of the *en banc* court, issued on January 9, 1987, reinstated the opinion and order of the panel. App. A. Because the court of appeals had stayed the orders of the lower courts terminating the automatic stay, United Savings was stayed from foreclosing under the deed of trust throughout the time this case was pending before the court of appeals.

---

[2] The jurisdiction of the district court was provided by 28 U.S.C. § 158(a); that statute provides, in relevant part, that "the district courts of the United States shall have jurisdiction to hear appeals from final judgments, orders, and decrees . . . of bankruptcy judges entered in cases and proceedings . . . ."

[3] The jurisdiction of the court of appeals was provided by 28 U.S.C. § 158(d), which provides that the court of appeals "shall have jurisdiction of appeals from all final decisions, judgments, orders, and decrees entered under [28 U.S.C. § 158(a) and (b)]."

SUMMARY OF ARGUMENT

The secured creditor has an interest in property of the bankruptcy estate. Under applicable state law, the secured creditor has a right to foreclose its security interest in property, to liquidate the property and reinvest the proceeds in a new investment. The automatic stay, provided in Bankruptcy Code section 362(a), takes effect on the filing of a bankruptcy case and stays the secured creditor from exercising these rights until a plan of reorganization is confirmed, the case is closed, or the stay is otherwise terminated. 11 U.S.C. § 362(a),(c). But the Bankruptcy Code does not allow the debtor or trustee to ignore the harm done by this stay to the value of the secured creditor's rights in property. Bankruptcy Code section 362(d)(1), 11 U.S.C. § 362(d)(1), requires the bankruptcy court to grant relief from the stay, "such as by terminating, annulling, modifying, or conditioning" the stay, "for cause, including the lack of adequate protection of an interest in property."

While not defining this requirement for "adequate protection," Bankruptcy Code section 361, 11 U.S.C. § 361, allows the court to provide such protection by requiring periodic cash payments to the extent that the automatic stay "results in a decrease in the value" of the secured creditor's interest in property, or by requiring an additional or replacement lien to the extent that the stay results in a decrease in such value, or by granting such other relief (other than an administrative priority) as will allow the creditor to realize "the indubitable equivalent" of its interest in property.

The ultimate issue in this case is whether Bankruptcy Code sections 362(d)(1) and 361 mean what they say: that the secured creditor is entitled to adequate protection of its interest in property, including any decrease in the value of that interest that results from the automatic stay. Bankruptcy Code section 362(d)(1) does not use the term "adequate protection" in a vacuum. This term has long had a meaning in bankruptcy law, where it has been used to require protection for the time value of rights in property. This is underscored by the language used in section 361(3), which uses the phrase "indubitable equivalent" in describing the general category of means of providing adequate protection; the phrase "indubitable equivalent" has also long been used, and is elsewhere in the Bankruptcy Code used, to require protection of the time value of rights in property. Above all, sections 362(d)(1) and 361 are directed to the value of interests in property, and are not limited to the value of the secured creditor's allowed claim or the value of the property itself. This emphasis on the value of the creditor's interest in property is akin to the treatment of secured creditors at confirmation of a plan

of reorganization; Bankruptcy Code section 1129(b)(2)(A), 11 U.S.C. § 1129(b)(2)(A), the so-called "cramdown" provision, also protects the value of the secured creditor's interest in property, and also is intended to protect the time value of the secured creditor's rights.

Although the statute is clearly directed toward protecting the value of the secured creditor's interest in property, the legislative history nowhere specifically addresses protection for the costs of delay imposed by the automatic stay. Some have therefore concluded, and the court below held, that Congress did not intend to protect this element of value. The reasons for this conclusion do not rest directly in the language of sections 362(d) and 361, but in negative implications from the legislative history and from other provisions of the Bankruptcy Code. Thus, many have relied upon the various statements in the legislative history that concern protection for the value of the collateral itself, and have concluded that protecting against decreases "in the value of [the secured creditor's] interest in such property" means nothing more than protecting against depreciation of the collateral. Others have relied on the rule stated in Bankruptcy Code section 502(b)(2), 11 U.S.C. § 502(b)(2), which excludes from the creditor's allowed claim all unmatured post-petition interest; the court below held that periodic cash payments under section 361(1), such as those required by the bankruptcy court in this case, are nothing but post-petition interest and are therefore prohibited by section 502(b)(2).

But these arguments, as well as other negative inferences from the Bankruptcy Code and its legislative history, miss the historical context of the statutory provisions at issue. It is true that pre-Bankruptcy Code cases do not require periodic post-petition payments to protect the secured creditor from the costs of delay, and it is also true that the legislative history does not specifically address whether such payments should be required under sections 362(d) and 361. Likewise, there is no pre-Bankruptcy Code authority that explicitly allows the payment of post-petition interest as compensation for such delay, and the legislative history does not address whether such post-petition interest should be paid. But a review of pre-Bankruptcy Code authorities makes this silence understandable. Pre-Code courts did not require periodic post-petition payments or other protection for the costs of delay, but this is not because pre-Code law did not protect the time value of rights in property; the absence of authorities conditioning the stay on post-petition payments follows from a *stricter* approach to the protection of secured creditor's rights in property.

A close examination of the pre-Code authorities reveals several common themes: (1) the debtor's lack of equity in property almost invariably was cause for relief from the automatic stay; (2) accruing interest was recognized as a harm to the secured creditor, and an important factor to be considered in granting relief from the automatic stay; and (3) where the debtor had no equity in property and could offer no security or protection for accruing interest, the automatic stay was generally terminated, rather than "conditioned" on some continuing protection fashioned by the bankruptcy court. The Bankruptcy Code made a radical departure from prior law in allowing the bankruptcy court to condition the automatic stay on adequate protection. Where courts previously would have had no choice but to terminate the automatic stay to protect the secured creditor, courts can now condition the stay on periodic payments or some other form of adequate protection. It was not until courts began to condition the automatic stay, following enactment of the Bankruptcy Code, that the issues raised in this case came to the fore.

What does underlie the legislative history of Bankruptcy Code sections 362(d) and 361, perhaps more clearly than any other theme, is the intent of Congress to protect the full value of secured creditors' rights. While acknowledging that bankruptcy stays and in some cases modifies secured creditors' rights, Congress sought to assure secured creditors "the benefit of their bargain" by protecting the full value of their rights in property. While the legislative history does not specifically address protection for the costs of delay, it does make clear that the value to be protected has an expansive meaning, and that this value was intentionally undefined and left to judicial interpretation. Since the value of a secured creditor's rights in property necessarily decreases when the creditor is stayed from exercising those rights for a period of time, adequate protection of the creditor's interest in property requires protection for the costs of delay.

This protection for the costs of delay, or the "time value" of rights in property, is entirely consistent with the interest provisions of the Bankruptcy Code. To begin with, requiring protection for the time value of rights in property, even when it takes the form of periodic post-petition payments, is not the same thing as interest. Such protection is not directed to interest on the creditor's allowed claim, but to the income that could have been earned on the property but for the automatic stay; this protection is more like rent for the use of the property than interest on the underlying debt. In some cases, of course, protecting the costs of delay may give the creditor sufficient value to allow for the recovery of post-petition interest. But in these circumstances, the Bankruptcy Code does allow the creditor to recover such interest. While

Bankruptcy Code section 502(b)(2) excludes post-petition interest from the creditor's allowed claim, bankruptcy law has long allowed for the revival of the right to recover interest in those situations in which equity demands. Bankruptcy Code section 506, 11 U.S.C. § 506, which defines the secured claim, allows for the recovery of post-petition interest in those circumstances in which the costs of delay have been protected throughout the bankruptcy case.

ARGUMENT

I.

BANKRUPTCY CODE SECTIONS 362(d) AND 361 BY THEIR TERMS REQUIRE PROTECTION FOR THE COSTS OF DELAY IMPOSED BY THE AUTOMATIC STAY.

Bankruptcy Code section 362(d), 11 U.S.C. § 362(d), requires the bankruptcy court in certain circumstances to grant relief from the automatic stay; the stay, which is imposed by Bankruptcy Code section 362(a), 11 U.S.C. § 362(a), restrains secured creditors from foreclosing their security interests or otherwise enforcing their rights in property of the bankruptcy estate. Perhaps the most important circumstance entitling the secured creditor to relief from the stay is "the lack of adequate protection" of the creditor's "interest in property." Pursuant to section 362(d)(1), the court shall grant relief from the stay, by "terminating, annulling, modifying, or conditioning" the stay, "for cause, including the lack of adequate protection of an interest in property of such party in interest." The meaning of "adequate protection" is the subject of Bankruptcy Code section 361, 11 U.S.C. § 361. While not precisely defining the term, that section states alternative means of providing such protection. Section 361 states that adequate protection of an interest in property may be provided by periodic cash payments, by an additional or replacement lien, or by such other relief (other than an administrative priority) as will allow the secured creditor "the indubitable equivalent" of its interest in property.

The concepts of "adequate protection" and "indubitable equivalent," as used in Bankruptcy Code sections 362(d) and 361, necessarily include protection for the costs of delay imposed by the automatic stay. These terms were not employed by Congress in a vacuum. Both "adequate protection" and "indubitable equivalent" had a history and a meaning in bankruptcy law at the time the Bankruptcy Code was enacted. Viewed in light of this history, against the backdrop of prior law on relief from stay and in the context of the contemporary legislative history, "adequate protection" can only be read to protect secured creditors from the costs of delay imposed by the automatic stay.

A. The Language of the Statute: "Adequate Protection" and "Indubitable Equivalent"

Any analysis of the meaning of "adequate protection" under the Bankruptcy Code should begin with the history and use of that phrase in bankruptcy law. "Adequate protection" was used in Chapter X, sections 216(7) and (8), and in Chapter XII, section 461(11), of the Bankruptcy Act of 1898 (hereinafter the "Bankruptcy Act")[4]; in each case, "adequate protection" was required of the "value of claims" of secured creditors and stockholders[5]. In this context, adequate protection of the secured creditor's interest in property was long interpreted to require protection of the time value of the creditor's rights. Judge Learned Hand's classic formulation of the adequate protection requirement, in *In re Murel Holding Corp.*, 75 F.2d 941 (2nd Cir. 1935), was followed by other courts and remained viable law at the time the Bankruptcy Code was enacted.[6]

---

[4] 11 U.S.C. §§ 616(7), (8), 861(11)(repealed 1978). These provisions replaced former section 77B(b)(4) and (5), which was repealed in 1938. Section 77B(b)(5) required the reorganization plan to provide creditors with "adequate protection for the realization by them of the value of their interests, claims, or liens."

Judge Hand authored the following often-cited language in support of the court's holding in *Murel Holding Corp.*:

> "It is plain that 'adequate protection' must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalent."

---

[5] "Claims" was a term broadly defined, in sections 106(1) and 406(2) of the Bankruptcy Act, to include "all claims of whatever character against a debtor or its property, except stock, whether or not such claims are provable under section 63 of this Act [which applied to liquidation cases under Chapter VII] . . . ." 11 U.S.C. §§ 506(1), 806(2)(repealed 1978).

[6] *See* Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. CHI. L. REV. 305, 311 n. 26 (1983), and cases cited therein; 6A COLLIER ON BANKRUPTCY (14th ed.) ¶ 10.12 at 53 n. 18. This longstanding history and meaning of the phrase "adequate protection" is important, for Congress is assumed to know the applicable law at the time it enacts a statute. *See, e.g., Cannon vs. University of Chicago*, 441 U.S. 677, 696-97, 60 L.Ed.2d 560, 99 S.Ct. 1946 (1979); *Finberg vs. Sullivan*, 461 F. Supp. 253, 258 (E.D. Pa. 1978), *vacated on other grounds*, 634 F. 2d 50 (3rd Cir. 1980). Thus, this Court has recognized "the familiar rule that where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary." *Case vs. Los Angeles Lumber Products Co.*, 308 U.S. 106, 115, 84 L.Ed. 110, 60 S.Ct. 1 (1939) (holding that the term "fair and equitable," as used in section 77B(f) of the Bankruptcy Act, includes the rule of "absolute priority" since the words "are words of art which . . . had acquired a fixed meaning through judicial interpretation").

In re Murel Holding Corp., 75 F.2d at 942. Judge Hand did note one qualification: "No doubt less will be required to hold up the suit for a short time until the debtor shall have a chance to prepare; much depends on how long he has had already, and upon how much more he demands." *Id.* at 943. But Judge Hand was interpreting a statute that required adequate protection only in the context of a reorganization plan; the Bankruptcy Act did not require adequate protection prior to the confirmation of a plan. "This qualification, of course, reflects the absence under the Bankruptcy Act of a statutory requirement for adequate protection during the stay, not to mention the absence of a requirement for an automatic stay." *In re American Mariner Industries, Inc., supra*, at 433.

That "adequate protection" of an interest in property was intended to have the same meaning in Bankruptcy Code sections 362(d) and 361 as it had been given elsewhere under the Bankruptcy Act is also clear from the use of the phrase "indubitable equivalent" in Bankruptcy Code section 361(3). That subsection allows the bankruptcy court to provide adequate protection of an interest in property by granting "such other relief . . . as will result in the realization by [the secured creditor] of the indubitable equivalent of such entity's interest in such property." This phrase undoubtedly comes from *Murel Holding Corp.* and its progeny; the phrase was also used in Bankruptcy Code section 1129(b)(2)(A)(iii), 11 U.S.C. § 1129(b)(2)(A)(iii), which was intended to follow *Murel Holding Corp.* in requiring plans of reorganization to protect the time value of secured claims. *See* S.REP.NO. 989, 95th Cong., 2nd Sess.(1978) (hereinafter the "Senate Report") at 127 ("The indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in *In Re Murel Holding Corp.* . . .); H.R.REP.NO. 595, 95th Cong., 1st Sess. (1977) (hereinafter the "House Report") at 414 ("This contemplates a present value analysis that will discount value to be received in the future . . . .").

Moreover, the language used in section 361(3) is important not only as a third method for providing adequate protection, but as the general category defining adequate protection. Although written before the phrase "indubitable equivalent" was added to section 361(3), the House Report makes clear that this subsection was intended to define the concept of adequate protection:

> "[Section 361(3)] also defines, more clearly than the others, the general concept of adequate protection, by requiring such relief as will result in the realization of value. It is the general category, and as such is defined by the concept involved rather than any particular method of adequate protection."

House Report at 340. Subsection 361(3) was intended, therefore, to state the general concept of adequate protection and to allow the bankruptcy court discretion in fashioning alternative means of adequate protection. That subsection requires "the indubitable equivalent" of the secured creditor's "interest in property," language that has long been interpreted to require protection of the time value of the secured creditor's rights.

The language in sections 362(d) and 361 can also be compared favorably with the language used in section 1129(b)(2)(A), the so-called "cram down" provision. This provision, which all agree entitles the secured creditor to the present value of its interest in property of the estate, requires the reorganization plan to provide for payments

to the secured creditor "of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property." This language was clearly intended to protect the time value of the secured creditor's rights,[7] and this language is virtually identical to that employed in section 361 to state the means of providing adequate protection. While section 1129(b)(2)(A) requires payment of "the value of [the secured creditor's] interest in the estate's interest in such property," section 361(1) and (2) require protection against any decrease "in the value of [the secured creditor's] interest in such property," and section 361(3) defines adequate protection as the "indubitable equivalent of [the secured creditor's] interest in such property."[8]

In summary, the language of Bankruptcy Code sections 362(d) and 361 indicates clearly that "adequate protection" requires protection of the value of the secured creditor's interest in property, including the time value of those rights. Sections 362(d) and 361 not only require protection of the secured creditor's interest in property, but require "adequate protection" and further define that term with the use of the phrase "indubitable equivalent"—both of which have long had a meaning requiring protection of the time value of the secured creditor's rights. And section 1129(b)(2)(A), the so-called cram down provision from which the "adequate protection" language was originally derived, itself uses language almost identical to that in section 361.

---

[7] *See* Senate Report at 127; House Report at 413.

[8] Unlike the cram down provision, section 361 does not state the date on which this present value is to be computed; this is to be expected, since section 361 can apply in numerous circumstances and at various stages during the bankruptcy proceeding, whenever a motion is filed for relief from stay, under section 362(d), or for authority to use, sell or lease property of the estate, under section 363. The language of section 361 is, indeed, defined more by its similarities to the cram down provision than by its differences. Like the cram down provision, section 361 requires protection of the value of the secured creditor's interest in property; neither the cram down provision nor section 361 refers to the value of the collateral or to the amount of the allowed secured claim, as assumed by the court below.

B. The Backdrop: Relief from the Stay Before Enactment of the Bankruptcy Code

The court below relied heavily on a review of pre-Bankruptcy Code law and on the legislative history of Bankruptcy Code sections 362(d) and 361. Because pre-Code law does not appear to allow for the payment of post-petition interest to undersecured creditors, 793 F.2d at 1385-86, and because the legislative history does not consider this issue, 793 F.2d at 1389-1401, the court below concluded that sections 362(d) and 361 could not have been intended to protect the costs of delay imposed by the automatic stay.

It is true that pre-Bankruptcy Code authorities did not require periodic payments, either as "interest" or as "adequate protection,"[9] as a condition for maintaining the automatic stay against undersecured creditors. But this is not because pre-Code authorities did not recognize the time value of secured creditors' rights and did not protect against the costs of delay imposed by the stay; instead, it results from the *stricter* approach to accruing interest taken

by pre-Code authorities. While employing different methods of analysis, pre-Code authorities did recognize the harm caused to secured creditors by the automatic stay, and did grant relief from the automatic stay, generally by *terminating* rather than conditioning the stay, because of unprotected accruing interest on undersecured claims.

Pre-Bankruptcy Code courts employed various modes of analysis in determining whether to grant relief from the stay to secured creditors.[10] But however they approached the issue, several common threads emerged from their decisions: (1) The debtor's lack of equity in property almost invariably was cause for relief from the automatic stay; exceptions were made only in unusual circumstances, generally because accruing interest was protected or secured; (2) Accruing interest was recognized as a harm to the secured creditor, and an important factor to be considered in granting relief from the automatic stay to such a creditor, whether oversecured or undersecured; and (3)

---

[9] The court below asserted that periodic payments, when required to protect the secured creditor against the costs of delay, necessarily constitute post-petition interest on the creditor's allowed claim. 793 F.2d at 1382 n.1. The Petitioner contests this assertion, *see infra* at 36-38. But regardless of how these payments might be characterized, the absence of cases conditioning the automatic stay on such payments can be properly understood only in the context of the law as it existed before enactment of the Bankruptcy Code.

[10] Most courts concentrated on four related issues: "The debtor's equity in the collateral, the likelihood of material harm to the secured creditor, the likelihood of rehabilitation, and the property's importance to the debtor's operations." L. Peitzman and M. Smith, *The Secured Creditor's Complaint: Relief from the Automatic Stay in Bankruptcy Proceedings*, 65 CAL. L. REV. 1216, 1226 (1977). *See also In re Hamilton Mortgage Corp.*, 1 C.B.C. 77 (Bkrpcy. E.D. Tenn. 1977); *In re Bric of America, Inc.*, 4 C.B.C. 34 (Bkrpcy. M.D.Fla. 1975); *In re Jennifer Mall Corp.*, 2 C.B.C. 657 (Bkrpcy. D.C. 1974); F. Kennedy, *The Automatic Stay in Bankruptcy*, 11 U. MICH. J. L. REF. 177, 238 *et seq.* (1978); G. Webster, *Collateral Control Decisions in Chapter Cases: Clear Rules vs. Judicial Discretion*, 51 AM. BANKR. L. J. 197 (1977). Some courts did not concentrate on these four factors, but instead sought to "balance the hurt" between the debtor and the creditor. Employing modes of analysis common to other injunction cases, these courts sought to determine whether the harm caused to the secured creditor was outweighed by the benefit to the debtor. *See Kaplan vs. Anderson*, 256 F.2d 416, 419 (5th Cir. 1958); *In re Groundhog Mountain Corp.*, 1 B.C.D. 923 (S.D.N.Y. 1975); L. Peitzman and M. Smith, *supra*, at 1229-30.

Where the debtor had no equity in property and could offer no security or protection for accruing interest, the automatic stay was generally terminated, rather than "conditioned" on some continuing protection fashioned by the bankruptcy court.

1. *Lack of Equity in Property of the Estate.* Although pre-Bankruptcy Code courts considered a number of factors in determining whether to grant relief from the automatic stay, the most important and often-cited factor was the debtor's equity in the property. As Professor Kennedy explained in his exhaustive survey of pre-Code automatic stay cases: "If the equity is nonexistent or thin and the debtor is unable to make payments of accruing installments of principal and interest of secured debt, the debtor's burden of justifying continuation of the stay is heavy indeed." F. Kennedy, *supra,* at 245. *See also* L. Peitzman and M. Smith, *supra,* at 1226-28 ("The idea of equity, then, has become something of a totem for the courts.")

The courts were particularly strict in Chapter XI cases, because Chapter XI courts did not have the power to affect the rights of secured creditors in a reorganization plan. In such cases, the lack of equity was almost invariably fatal to the debtor's attempts to retain property.[11] The absence of equity was not necessarily fatal in Chapter X (corporate reorganization, including all debt) or Chapter XII (noncorporate reorganization involving primarily real estate debts), since under both chapters the bankruptcy court had the power to modify secured debts in a reorganization plan. Therefore, some courts under Chapters X and XII did allow continuation of the automatic stay despite the absence of equity. But on close examination, these were exceptional cases in which accruing interest was protected or the secured creditor for some other reason was not harmed by continuation of the automatic stay.[12]

---

[11] *See F. Kennedy, supra,* at 247; V. Countryman, *Real Estate Liens in Business Rehabilitation Cases,* 50 AM. BANKR. L. J. 303, 312 *et seq.*, 1976.

2. *Delay as a Harm to Secured Creditors.* Many pre-Bankruptcy Code courts recognized that the position of a secured creditor was eroded during the course of a bankruptcy proceeding while the creditor was stayed from liquidating its collateral. This erosion was evident both for oversecured and for undersecured creditors, and was a factor taken into account by courts hearing motions for relief from stay under Chapters X, XI and XII of the Bankruptcy Act.[13] In short, there are numerous pre-Bank-

---

[12] One justification for continuing the automatic stay despite the absence of equity in a Chapter X or XII case was the likely increase in the value of the collateral. *See Reconstruction Finance Corp. vs. Kaplan,* 185 F.2d 791 (1st Cir. 1950) (undersecured creditor with liens on uncompleted inventory not entitled to relief from stay where debtor's completion of work in process increases collateral value); *In re Nevada Towers Associates,* 14 C.B.C. 146 (Bkrpcy. S.D.N.Y. 1977) (undersecured creditor with lien on uncompleted apartment house not entitled to relief from stay where post-petition interest would be recovered by increase in value of building upon completion by debtor). Similarly, a Chapter XII court allowed continuation of the automatic stay against an undersecured creditor because the creditor had announced its intention "to hold the property after bidding it in at foreclosure"; because the creditor had no alternative use for the property, the court found that it was not "irreparably harmed" by the stay. *In re Castle Village Company,* 13 C.B.C. 452, 463 (Bkrpcy. S.D.N.Y. 1977) And in some cases of doubtful equity, the courts gave the debtor the benefit of the doubt, early in the case, over conflicting appraisals. *See In re Plaza Towers, Inc.*, 294 F. Supp. 714, 723-24 (D.C. E.D. La. 1967).

[13] The following cases, all recognizing the harm caused to the secured creditor by the delay imposed by the automatic stay, were decided within four years of the enactment of the Bankruptcy Reform Act of 1978: *In re Hamilton Mortgage Corp.*, 13 C.B.C. 77, 99 (Bkrpcy. E.D. Tenn. 1977) (granting relief from the automatic stay, finding detriment to the secured creditor "because accruing interest reduces the amount, if any, by which the value of the property exceeds the amount of the debt); *In*

(Continued on following page)

ruptcy Code cases that consider the time value of secured creditors' rights. These cases recognize that a secured creditor has an interest in property, that the interest would have entitled the creditor to the use of the property for the purpose of discharging the debt but for the automatic stay, and that this interest loses value as the creditor is precluded for a period of time from enforcing its rights in the property.

3. *Terminating Rather Than Conditioning the Automatic Stay.* There are few if any pre-Bankruptcy Code cases in which debtors are ordered to make periodic post-petition payments to undersecured creditors to protect the time value of rights in property. But this is not because pre-Code courts did not recognize and protect the time value of secured creditors' rights. It follows, instead, from the *stricter* approach taken by pre-Code courts to the protection of such rights. As the cases cited above demonstrate, *see supra* at n. 13, pre-Code courts did not generally condition the automatic stay on cash payments or other forms of adequate protection; instead, the courts simply terminated the automatic stay in the absence of equity or other protection for secured creditors.

Case conditioning rather than terminating the automatic stay are therefore noteworthy. Chief among these cases are *In re Bermec Corporation*, 445 F.2d 367 (2nd Cir. 1971), and *In re Yale Express System, Inc.*, 370 F.2d 433 (2nd Cir. 1966) and 384 F.2d 990 (2nd Cir. 1967). In *Bermec*, the court approved payments to the secured creditors to compensate for "the 'economic depreciation' on the secured creditors' equipment so as approximately to preserve their status quo." 445 F.2d at 369. In *Yale Express*, the court of appeals originally suggested that the bankruptcy court consider whether the debtor should "make rental payments for the use" of collateral during the bankruptcy proceeding, 370 F.2d at 439, and ultimately approved the granting of an administrative priority in lieu of such payments, 384 F.2d at 992. *Bermec* and *Yale Express* are notable because they allow the bankruptcy court to continue the automatic stay if it is properly conditioned on payments, on alternative liens, or on some other compensation that adequately protects the creditor's interest in property.

It is misleading, therefore, to point to the absence of pre-Code authority conditioning the automatic stay on periodic interest payments. Pre-Code law did not generally condition the automatic stay on anything, but simply terminated the stay where the secured creditor's in-

---

(Continued from previous page)

re Lax Enterprises, 11 C.B.C. 628, 631 (Bkrpcy. N.D. Ohio 1976) (granting relief from the stay despite an equity cushion because "it is apparent that within a very short period of time the mortgage and interest accruing could exceed the value of the property"); *In re Sixth Avenue Investment and Development Company*, 2 B.C.D. 1222, 1225 (Bkrpcy. S.D. Cal. 1976) (granting relief from the stay despite a small equity cushion, in part because "the plaintiff is being deprived of the use of its money during the pendency of the Chapter XII proceeding stays"); *In re Hartsdale Associates*, 11 C.B.C. 87, 93 (Bkrpcy. S.D.N.Y. 1976) (granting relief from the stay in part because of accruing interest, finding that "time is working against the secured creditors and they have received no consideration for their eroding position"); *In re Overmyer Company, Inc.*, 10 C.B.C. 389, 393 (Bkrpcy. S.D.N.Y. 1976) (granting relief from the stay in part because of "the inexorable interest accrual" that further erodes the secured creditor's position); *In re Groundhog Mountain Corp.*, 1 B.C.D. 923, 925-26 (Bkrpcy. S.D.N.Y. 1975) (balancing the hurt between the parties, granting relief from the stay in part because current interest had not been paid); *In re Bateman Financial Corp.*, 5 C.B.C. 488, 492 (Bkrpcy. N.D. Fla. 1975) (granting relief from the stay to an oversecured creditor whose position was erased by accruing interest); *In re Jennifer Mall Corp.*, 2 C.B.C. 657, 662-63 (Bkrpcy. D. C. 1974) (granting relief from the automatic stay despite small equity, because of rapidly accruing interest); *In re O. K. Motels*, 1 C.B.C. 416, 420 (Bkrpcy. N.D. Fla. 1974) (granting relief from the stay to an undersecured creditor because of accruing interest).

terest in property was being harmed, whether by deterioration of its collateral or by unprotected accruing interest on its debt. Because section 362(d) allows the bankruptcy court to condition as well as terminate the automatic stay, courts are now likely to continue the stay, conditioned on adequate protection payments, under circumstances that previously would have justified termination of the stay. The change has been one of method, and does not negate the importance of pre-Code authorities protecting the time value of secured creditors' rights.

C. The Legislative History of the Bankruptcy Code

Neither the House and Senate Reports, nor any other portion of the legislative history of the Bankruptcy Code, directly addresses whether adequate protection under sections 362(d) and 361 includes protection of the costs of delay imposed by the automatic stay. The court below relied heavily on this silence as an indication that Congress did not intend to change long-standing law purportedly prohibiting the payment of interest to under-secured creditors. But because pre-Code authorities did recognize and protect the time value of secured creditors' rights, this silence can just as well be read to support an inference that Congress intended to continue such protection. A closer review of the legislative history demonstrates, indeed, that while Congress expanded the bankruptcy court's authority to continue the automatic stay by conditioning the stay on adequate protection, Congress intended to protect the full value of the secured creditor's rights.

The Commission on Bankruptcy Laws of the United States, established by Congress in 1970, provided in 1973 the first draft legislation for the new bankruptcy act. Section 7-203 of the proposed act authorized the trustee's or debtor's use of property subject to a lien until termination

of the automatic stay, and authorized the bankruptcy court either to terminate the stay or to modify the stay "by imposing such conditions . . . as will adequately protect the secured party." This proposed section had no predecessor in the Bankruptcy Act; the section proposed the very first statutory authorization for the use of property subject to a lien. The Commission proposal was based on limited case authority authorizing the use of such property despite continuing harm to the secured creditor, by conditioning such use on protection of the secured creditor. The Commission explained:

> "This section is new. It is essentially a codification of such cases as *In re Yale Express System, Inc.* . . . and *In re Bermec* . . . ."

Report of the Commission on the Bankruptcy Laws of the United States (hereinafter the "Commission Report") at 236. By adopting the approach of the *Yale Express* and *Bermec* courts, this proposal for the first time allowed the bankruptcy court an alternative to terminating the automatic stay to protect secured creditors; this approach, later incorporated in Bankruptcy Code section 362(d), allows the court to condition the automatic stay on such requirements, including periodic payments, as will "adequately protect the secured party."

While the Commission proposed this bold change allowing the court to condition the stay, the Commission did not attempt to limit or define the content of adequate protection. Indeed, the Commission could not have more clearly stated its intent *not* to codify, or even to comment upon, the case law concerning protection of secured creditors. This is the Commission's explanation of section 7-203(b), which authorized both the termination of the stay and the conditioning of the stay on adequate protection:

> "In addition to recognizing the right to use collateral ends upon the lifting of the stay, this section gives the court discretion to impose conditions on the use of property. If a lessor or secured creditor is dissatisfied, this remedy is to file a complaint with the court. *No attempt has been made to codify the case law as to when the use of collateral must cease or as to the adequacy of protection in any given situation. This if left to case-by-case interpretation by the courts. . . .*"

Commission Report at 237 (emphasis added). The Commission did list several examples of conditions that may be imposed by the court, including "requiring additional security to the extent of the anticipated decrease in the value of the collateral as a result of use". But this hypothetical condition is the *only* reference made to decreases in the value of the collateral. Nowhere does the Commission Report define this decrease in collateral value as the sole object of adequate protection; this is not surprising, since the Commission expressly disclaimed any attempt to codify or define "the adequacy of protection in any given situation."

Congress also chose not to limit or define the meaning of adequate protection. The House and Senate Reports cite *Yale Express* and *Bermec* as examples of conditions that might be imposed for continuation of the automatic stay. Neither report undertook to limit or define adequate protection, and the Senate Report expressly reserved the question of "whether the payments offered in [*Bermec*] are adequate to compensate the secured creditors for their loss." Senate Report at 54. Both reports stated that the value to be protected under section 361 was left largely to judicial development. Congress recognized that section 361 "does not specify how value is to be determined, nor does it specify when it is to be determined," and Congress left these matters "to case-by-case interpretation and development". House Report at 339; Senate Report at 54.

Congress chose not to define adequate protection, and it is therefore not surprising that the legislative history does not specifically address protection for the costs of delay. But the legislative history does make clear the intent of Congress that secured creditors received the benefit of their bargain, and not merely an assurance of the physical protection of their collateral. While the Bankruptcy Code may limit or change the secured creditor's rights in various respects, *see infra* at n. 21, still the secured creditor must receive the *value* of its security interest. The House Report emphasizes the breadth of the adequate protection requirement:

> "[Section 361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. *Secured creditors should not be deprived of the benefit of their bargain.* There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. *Though the creditor might not receive his bargain in kind, the purpose of the section is to ensure that the secured creditor receives in value essentially what he bargained for.*"

House Report at 339 (emphasis added). *See also* Senate Report at 53 ("Though the creditor might not retain his lien upon the specific collateral held at the time of filing, the purpose of [section 362(d)] is to insure that the secured creditor receives the value for which he bargained.")

In sum, Congress did not attempt to define "adequate protection" and did not specifically consider whether the secured creditor would be entitled to protection for the costs of delay imposed by the automatic stay. This is no doubt why the issues raised in this case have been so hotly debated for so long. But several conclusions remain clear from the language of the Bankruptcy Code and its legislative history: sections 362(d) and 361 were designed to protect the value of secured creditors' interests in property of the estate, and to assure that such creditors receive the full "benefit of their bargain"; that value is to have a flexible meaning, left to case-by-case interpretation by the courts; and nowhere does the legislative history reject pre-Code authorities that protect the time value of secured creditors' rights.

II.

THE SECURED CREDITOR IN A BANKRUPTCY CASE IS ENTITLED TO THE VALUE OF ITS NON-BANKRUPTCY RIGHTS IN PROPERTY, AND THIS REQUIRES PROTECTION FOR THE COSTS OF DELAY, IMPOSED BY THE AUTOMATIC STAY, IN THE EXERCISE OF THOSE RIGHTS.

Bankruptcy Code section 362(d)(1) entitles the secured creditor to relief from the stay in the absence of "adequate protection" of its "interest in property". Bankruptcy Code section 361(1) and (2) allows the court to require such protection through cash payments or alternative liens to the extent that the automatic stay "results in a decrease in the value of [the secured creditor's] interest in such property." Likewise, section 361(3) allows the court to require such protection with such other relief as "will result in the realization by [the secured creditor] of the indubitable equivalent of [its] interest in such property." This language is important, for in each case it is the *value of the creditor's interest in property*, rather than the amount of the allowed secured claim or the value of the property itself, that is entitled to protection.[14] This language contrasts sharply with that employed by Congress in the adequate protection provision now applicable to family farmers, which is found in Bankruptcy Code section 1205, 11 U.S.C. § 1205.[15] Section 1205(b)(1), (2) and (4), which defines adequate protection for family farmer cases, requires protection only against any "decrease in the value of property securing" the creditor's claim. Congress has thus distinguished between the value of property of the estate and the value of the creditor's interest in that property.[16]

---

[14] Protecting the value of the creditor's interest in property is likewise the focus of the cram down provision, 11 U.S.C. § 1129(b)(2)(A), which entitles the creditor to payments of at least "the value" of the creditor's "interest in the estate's interest in such property." This distinction between the value of the creditor's claim and the value of its interest in property was also recognized in the reorganization provisions of the Bankruptcy Act, which defined "claims" entitled to protection to include claims "against the debtor *or its property*" (emphasis added). *See infra* at n. 5. That "adequate protection" reaches the value of rights in property, and not only the amount of the allowed secured claim, is also clear from the reach of section 362(d)(2), which protects not only secured creditors but *all* parties that have interests in property of the bankruptcy estate. *See* Senate Report at 49 (stating that section 362 is intended to protect "the interest of a secured creditor or co-owner of property with the debtor").

[15] The Bankruptcy Judges, United States Trustee, and Family Farmer Bankruptcy Act of 1986 (hereinafter the "Family Farmer Act") was adopted by the House and Senate, and signed by the President, in October, 1986. The Family Farmer Act includes a number of provisions favorable to family farmer debtors, a group that includes individuals whose primary business is farming and whose total assets fall below certain specified limits.

[16] The fact that Congress eliminated protection for the time value of secured creditors' rights in family farmer cases can be read as Congressional disapproval of such protection in all cases. This was the conclusion reached by the court below, which made note of testimony, before Congressional subcommittees, disapproving such protection. 808 F.2d at 364-68. But this act of Congress can also be read as an acknowledgment that protection of time value is required in non-family farmer cases,

(Continued on following page)

This distinction is not mere verbage. A secured creditor has an interest in property of the estate, and the value of that interest is not the same as the value of the property itself. The essence of a security interest, which is defined by the security agreement and applicable nonbankruptcy law,[17] is not the right to possess and use the property; the secured creditor has not set out to buy the property and does not care to use it. Instead, the secured creditor has a claim to repayment of a specific debt from the property, and a right to liquidate the property and apply the proceeds to the debt. "The secured creditor's ultimate remedy is to sell the asset and thereby realize the asset's value in the marketplace. In practice, then, a secured creditor only has the right to the cash he could raise upon the sale of the property, not to any value deriving from its continued use." Baird and Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy,* 51 U. CH. L. REV. 97, 113-14 (1984).

An essential component of the secured creditor's rights therefore consist of the timing of its foreclosure. The secured creditor is entitled to foreclose at a specified time (typically when the debtor defaults), to recover the collateral proceeds and reinvest them. If, as the court below held, the Bankruptcy Code protects only the physical condition of the collateral, and does not compensate the secured creditor for preventing the exercise of these property rights during the bankruptcy proceeding, then the secured creditor is deprived of a substantial value. That value is measured by "the income lost by the secured creditor while he is stayed from re-lending the value of the collateral," 808 F.2d at 376-77 (Jones, J., dissenting), an amount which in this case the bankruptcy court found to be $42,500 per month.

The time value of rights in property has long been recognized outside of bankruptcy law. A party whose property has been wrongfully injured or withheld may recover damages not only for the cost of repairing his property or for the permanent loss caused to the market value of his property, but also for any temporary loss of the use of his property.[18] This Court only recently held

---

(Continued from previous page)

since no change was made to Bankruptcy Code sections 362(d) and 361; indeed, statements made on the floor of the House and Senate recognize that sections 362(d) and 361 do require protection of the time value of secured creditors' rights. See Congressional Record H8999 (October 2, 1986) (joint explanatory statement of the conference committee); Congressional Record S5558 (May 7, 1986) (Senator Grassley). The important point about the Family Farmer Act is not, therefore, the unstated Congressional intent as to non-family farmer cases; about that one can only speculate. The more important lesson is the *language* used by Congress in section 1205(b), for the fact remains "that Congress there was able to find the words needed to limit adequate protection to the value of the secured creditor's collateral." 808 F.2d at 378 (Jones, J., dissenting).

[17] *Butner vs. United States,* 440 U.S. 48, 55, 59 L.Ed.2d 136, 99 S.Ct. 914 (1979) ("Property interests are created and defined by state law . . . . The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee . . . .").

[18] *See generally* 25 C.J.S. *Damages* § 41, at 731-33, and § 84, at 926-28; *Klein vs. Tabatchnik,* 610 F. 2d 1043, 1055-56 (2nd Cir. 1979) (" . . . loss of use is an element of damage compensableable as a separate item from the costs of repair"); *Superior Construction Co. vs. Elmo,* 102 A. 2d 739, 743-44 (Md. Ct. App. 1954) (". . . complete satisfaction must take account of the loss of personal enjoyment and use, independently of and beyond the difference in market value or cost of restoration."). Thus, courts have allowed interest or other damages for the temporary conversion of personal property. *See* 89 C.J.S. *Trover and Conversion* §§ 171, 172; *3-C Oil Company vs. Modesta Partnership,* 668 S.W. 2d 741, 751-52 (Tex.Civ.App.—Austin 1984, writ ref.

(Continued on following page)

that this value is also protected by the Just Compensation Clause of the Fifth Amendment, which was interpreted to require compensation for the temporary taking of property.[19] Like the owner whose property has been only temporarily injured or withheld, or whose property has been only temporarily taken by government action, the secured creditor also has rights in property that lose value when they are temporarily withheld or taken. State courts have recognized this important element of value, and have in various circumstances protected the secured creditor from wrongful losses in the time value of its rights in property.[20]

(Continued from previous page)

n.r.e.). Courts have also allowed interest or other damages for the wrongful injunction that temporarily interferes with rights in real or personal property. *See* 43A C.J.S. *Injunctions* §§ 335-36.

[19] *First Evangelical Lutheran Church of Glendale vs. County of Los Angeles*, 55 U.S.L.W. 4781, 4785-86 (1987) (measuring compensation for the temporary taking by "the value of the use of the land during this period.").

[20] The secured creditor whose collateral has been converted for a period of time may recover damages for the temporary loss of its right to liquidate the collateral. *See Chattanooga State Bank vs. Citizens State Bank*, 134 P. 954, 956 (Okl. S. Ct. 1913) (measure of damages for detention of cattle securing a loan "is the interest on the money [the bank] would have received for the cattle had it been permitted to take and sell them under its mortgage"); *Barron vs. San Angelo National Bank*, 138 S.W. 142, 145 (Tex.Civ.App.—Austin 1911, writ ref.) (allowing interest "on the value of the animals converted . . . from the date of such conversion"); *Klinkert vs. Fulton Storage and Mercantile Co.*, 89 N.W. 507, 510 (Wis. S. Ct. 1902) (limiting damages for conversion of security to "the value of said property and interest on such value from the time it was so taken"). A real property mortgagee that has been wrongfully enjoined from foreclosure is in a similar situation; thus, the mortgagee may recover damages for the wrongful temporary injunction of its foreclosure. *See Surety Savings and Loan Association vs. National Automobile and Casualty Insurance Co.*, 87 Cal. Reptr. 572, 576 (Cal. App. 1970) ("The delay in the sale caused a loss of the use of the money that would have been paid if the sale had not

(Continued on following page)

It is clear that Congress has the constitutional authority not only to restrict the manner in which security interests are enforced but also to limit or even invalidate security interests.[21] But while Congress has chosen to restrict the secured creditor's ability to enforce its property rights during a bankruptcy case, Congress has also chosen to protect the *value* of those property rights. The Bankruptcy Code does not define or limit this value that is entitled to protection. *See infra* at 25-27. But both the House and Senate Reports emphasized the breadth of this protection in passages that deserve repeating. The House Report explained: "Secured creditors should not be deprived of the benefit of their bargain. . . . Though the creditor might not receive his bargain in kind, the purpose of the section is to ensure that the secured creditor receives in value essentially what he bargained for." House Report at 339. The Senate Report concurred: "Though the creditor might not be able to retain his lien upon the specific collateral held at the time of filing, the purpose of [section 362(d)] is to insure that the secured creditor receives the value for which he bargained." Senate Report at 53.

No similar statements are made in the legislative history concerning unsecured creditors. It could not be said that unsecured creditors are entitled "to the benefit of

---

(Continued from previous page)

been delayed. Interest on the [amount bid] during the time of the delay is a measure of damage for the loss of its use.").

[21] U.S. Const., art. I, § 8, cl. 4; *Butner vs. United States*, 440 U.S. 48, 54, 59 L.Ed. 2d 136, 99 S.Ct. 914 (1979). *See* J. S. Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 977-1012 (March, 1983). This Court has suggested that the Constitution may, however, limit the reach of the bankruptcy clause with respect to retroactive application to secured creditors. *United States vs. Security Industrial Bank*, 459 U.S. 70, 74 L.Ed. 2d 235, 103 S.Ct. 407 (1982).

their bargain," for unsecured creditors may have their claims reduced and paid over time, and perhaps discharged entirely. But the secured creditor is more than a claimant, for such a creditor has bargained for an interest in property. The secured creditor's rights in property, like all other rights in property, is defined by state law; the Bankruptcy Code may vary the enforcement of such rights but nevertheless protects their value.

The Bankruptcy Code's protection of the value of the secured creditor's interest in property was recognized by this Court in *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 76 L. Ed. 2d 515, 103 S. Ct. 2302 (1983). The issue in *Whiting Pools* was the reach of the turnover provision, 11 U.S.C. § 542, as to property in the possession of a creditor holding a security interest in the property; the Court held that section 542 modified the creditor's "procedural" right to possession of collateral by granting to the bankruptcy estate "a possessory interest in certain property of the debtor that was not held by the debtor at the commencement of reorganization proceedings." 462 U.S. at 206-07. But the Court did not hold that the *value* of this possessory right to the secured creditor was impaired by bankruptcy law; to the contrary, the Court emphasized that this procedural right had been *replaced* by other procedural rights in bankruptcy, including the right to adequate protection: "The Bankruptcy Code provides secured creditors various rights, including the right to adequate protection, and these rights replace the protection afforded by possession." 462 U.S. at 207.

If the secured creditor's right to adequate protection in bankruptcy replaces the creditor's right to possession of property under non-bankruptcy law, then adequate protection must be comparable to possession in some meaningful sense. The secured creditor does not, of course,

want to possess the property for personal use, nor is the secured creditor interested in the preservation or security of the property for its own sake. The secured creditor seeks only the economic benefit of the property, which if repossessed and sold at foreclosure sale will allow the creditor to recover a part of its debt. The automatic stay prevents the exercise of this right for a period of time, causing a permanent loss to the secured creditor of the income that could have been earned during that period on the reinvested collateral proceeds.[22]

Fundamentally, the error of the court below is its failure to protect the value of state law rights in property, contrary to Congress' mandate of "adequate protection" and contrary to prior decisions of this Court. Nowhere does the court below address the value of the secured creditor's interest in property—that is, the value of the right to foreclose on property at a given point in time and to reinvest the collateral proceeds. Under applicable state law, the secured creditor is entitled to the economic benefits of the property in which it holds a security interest, including the income that may be earned on the reinvested collateral proceeds. While the procedural right to take possession of the property and foreclose its security interest is automatically stayed in bankruptcy, the secured creditor instead is entitled to "adequate protection" of its interest in property. This interest in property of the bankruptcy estate cannot be "adequately protected" in any meaningful sense if the time value of rights in property is ignored.

---

[22] Thus, the bankruptcy court in *Whiting Pools* did not protect merely the liquidation value of the property, which the court held was $35,000; instead, the bankruptcy court conditioned the debtor's use of the property on the immediate payment of $20,000 plus monthly payments of $1,000 "until the [debt was] satisfied." 462 U.S. at 201, n.7.

III.

PROTECTION FOR THE COSTS OF DELAY IMPOSED ON THE SECURED CREDITOR BY THE AUTOMATIC STAY IS CONSISTENT WITH THE INTEREST PROVISIONS OF THE BANKRUPTCY CODE.

A. Protection for the Costs of Delay, Even When Provided by Periodic Post-Petition Payments, Does Not Constitute Interest on the Creditor's Allowed Claim.

The secured creditor can be protected in various ways from the costs of delay imposed by the automatic stay; relying on the alternatives allowed by Bankruptcy Code section 361(1) through (3), the court may find that an additional or alternative lien, a sufficient equity cushion, increasing property value or other "indubitable equivalent" will protect the creditor. It is only in a case such as this one—where the debtor admittedly has no equity in the sole asset of the estate, has no plan for increasing that value, and has no alternative or additional lien to offer—that the court must resort to the periodic post-petition payments authorized by Bankruptcy Code section 361(1).

The court below characterized these periodic post-petition payments, which the bankruptcy court required as a condition to the automatic stay in this case, as "simply post-petition interest payments in sheep's clothing." 793 F.2d at 1382 n. 1. But these periodic payments are not intended to compensate the secured creditor for the use of its *money*, and therefore are not interest.[23] Instead, these payments are intended to compensate the creditor for the use of *property* in which it holds a security interest; the payments are more like *rent* than interest.[24] Payments

---

[23] *Black's Law Dictionary* 729 (5th ed. 1979) (defining "interest" as "compensation allowed by law or fixed by the parties for the use or forebearance or detention of money").

[24] *Black's Law Dictionary* 1166 (5th ed. 1979) (defining "rent" as "consideration paid for use or occupation of property").

under section 361(1) are measured not by interest on the creditor's claim, but by the income that could have been earned on the reinvested collateral proceeds had the creditor been allowed to liquidate its collateral. Thus, the bankruptcy court in this case did not require the immediate payment of interest on United Savings' allowed secured claim; instead, the court conditioned the automatic stay on payments equal to the amount that could have been earned on the reinvested collateral proceeds, beginning at the time by which United Savings could have sold the collateral and reinvested the proceeds. In some cases these periodic payments will approximate interest on the creditor's allowed claim, but in most cases they will be considerably less than such interest[25] and in some cases may be higher than interest on the allowed claim.[26]

But while these periodic post-petition payments are not measured by interest on the secured creditor's claim, the payments will in some cases allow the creditor to recover such interest. Whether the creditor ultimately receives post-petition interest will depend on the timing and amounts of periodic post-petition payments, and also on the extent to which the creditor is undersecured. A creditor that is substantially undersecured must receive substantial post-petition payments even to recover the deficiency remaining as of the date the petition was filed. On the other hand, a creditor that is only marginally undersecured, or the value of whose security roughly equals its claim as of the date of bankruptcy, may receive sufficient periodic payments to cover post-petition interest on its allowed claim. Because periodic payments will in some cases allow the secured creditor to recover post-petition interest, protecting the secured creditor from the costs imposed by the automatic stay must be squared with the interest provisions of the Bankruptcy Code.

---

[25] Adequate protection payments are limited to the return that could have been earned (even if less than the contractual interest rate) on the liquidation value of the collateral (even if less than the secured claim). Likewise, the bankruptcy court in this case held that such payments need not begin until such time as the creditor could have liquidated the collateral and reinvested the proceeds in the absence of bankruptcy. 49 B.R. at 458-59. This holding has been challenged by the Petitioners in a case now pending before the Court, *Norwest Bank Worthington and Federal Land Bank of St. Paul vs. Ahlers,* 794 F.2d 388 (8th Cir. 1986), *cert. granted,* no. 86-958, but is not challenged by the Petitioner in this case.

[26] If a secured debt has a contractual interest rate that is less than the current market rate, the automatic stay prevents the reinvestment of collateral proceeds at the higher market rate; adequate protection may therefore require periodic payments calculated on the higher market rate rather than the lower contract rate.

B. The Interest Provisions of the Bankruptcy Code Allow the Secured Creditor to Recover Post-Petition Interest to the Extent that the Creditor Receives Periodic Post-Petition Payments or other Protection for the Costs of Delay.

Bankruptcy Code section 502(b)(2), 11 U.S.C. § 502 (b)(2), states the general rule with respect to post-petition interest; that section provides that a claim shall be determined as of the date of the filing of the petition and that such claim shall not be allowed to the extent that it is a claim "for unmatured interest." Section 502(b)(2) is a continuation of the rule stated in section 63(a) of the Bankruptcy Act,[27] and it thereby preserves the preexisting

---

[27] Section 63(a) of the Bankruptcy Act, 11 U.S.C. § 103(a) (repealed 1978), defined provable claims for Chapter VII (liquidation) cases; section 63(a)(1) allowed interest "which would have been recoverable [at the time of the filing of the petition] or with a rebate or interest upon such as were not then payable and did not bear interest." This disallowance of post-petition interest was not stated in provisions defining claims in reorganization cases, under Chapters X (section 106(1)), XI (section 307 (2)) and XII (section 406(2)), which in each case included "all

(Continued on following page)

principle that "interest stops accruing at the date of the filing of the petition." Senate Report at 63. One must be careful, however, not to expand this rule beyond its reach. Section 502(b)(2) does not state a substantive rule of law, and does not prohibit the bankruptcy court from awarding post-petition interest in all cases. Instead, section 502(b)(2) states a procedural rule of liquidation; the rule is intended to facilitate the convenient calculation of claims in the typical case where assets are insufficient to pay even the principal amount of claims. Thus, this Court has long recognized that the ancient rule prohibiting the calculation of post-petition interest in bankruptcy follows "not because the claims [have] lost their interest-bearing quality during that period," but instead as "a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full." *American Iron & Steel Manufacturing Company v. Seaboard Air Line Railway*, 233 U.S. 261, 266, 58 L.Ed. 949, 953, 34 S.Ct. 502 (1914).[28]

(Continued from previous page)

claims of whatever character . . . whether or not such claims are provable under section 63 of this Act. . . ." 11 U.S.C. §§ 506(1), 708(2), 806(2) (repealed 1978).

[28] *See generally* 3 COLLIER ON BANKRUPTCY (15th Ed.) ¶ 502.02 at 502-33 *et seq.*; 3A COLLIER ON BANKRUPTCY (14th Ed.) ¶ 63.16 at 1858-59. This rule prohibiting the calculation of post-petition interest developed in the liquidation context. Section 63(a) of the Bankruptcy Act, which incorporated the rule, applied only to ordinary bankruptcy (liquidation) cases, under Chapter VII of the Act. Creditors' claims were defined more broadly, without this limitation, under the reorganization provisions of Chapters X, XI and XII of the Act. *See infra* at n. 5; 6 COLLIER ON BANKRUPTCY (14th Ed.) ¶ 9.05. The rule was nevertheless expanded to reorganization cases by courts interpreting *Vanston Bondholders Protective Committee vs. Green*, 329 U.S. 156, 91 L.Ed. 162, 67 S.Ct. 237, (1946), in which the Court refused to allow first mortgage bondholders to receive interest on interest in a Chapter X case. Although the *Vanston* court did not disapprove of the payment of simple interest to

(Continued on following page)

As a result of the rule expressed in Bankruptcy Code section 502(b)(2) and its predecessors, post-petition interest is not a part of the creditor's allowed claim, whether secured or unsecured; the claim is calculated as of the date of the petition, and cannot include unmatured interest. But as a matter of substantive law, interest continues to accrue and, under appropriate circumstances, will be revived.[29] The courts have long recognized three typical circumstances in which post-petition interest may be paid to creditors, in liquidation as well as in reorganization cases. One circumstance applies to both unsecured and secured creditors: all creditors are entitled to recover interest on their claims where the bankruptcy estate is solvent, and creditors must be paid post-petition interest before the debtor recovers anything.[30] Two other circumstances in which courts typically have allowed post-petition interest apply only to secured creditors. It has long been recognized that the secured creditor is entitled to post-petition interest when the value of its security is sufficient to cover such interest,[31] and it has likewise been recognized that the secured creditor may recover interest from income generated post-petition by the property securing its debt.[32] In each of these circumstances, equity demands that the creditor recover post-petition interest even though its claim was originally calculated as of the date of the petition and did not include unmatured interest.[33]

(Continued from previous page)

the bondholders, subsequent courts nevertheless interpreted *Vanston* to extend the rule against post-petition interest, previously applicable only in liquidation cases, to reorganization cases under Chapters X and XI. *See Massachusetts vs. Thompson,* 190 F.2d 10 (1st Cir. 1951), *cert. den'd,* 342 U.S. 918, 96 L.Ed. 686, 72 S.Ct. 364 (1952); *United States vs. Edens,* 189 F.2d 876 (4th Cir. 1951), *aff'd per curiam,* 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 357 (1952); *United States vs. General Engineering & Manufacturing Company,* 188 F.2d 80 (8th Cir. 1951), *aff'd per curiam,* 342 U.S. 912, 96 L.Ed. 682, 72 S.Ct. 358 (1952).

[29] This principle dates to the English bankruptcy law of the eighteenth and nineteenth centuries. Blackstone explained: "And therefore, though the usual rule is, that all interest on debts carrying interest shall cease from the time of issuing the [bankruptcy] commission, yet, in case of a surplus left after payment of every debt, such interest shall again revive, and shall be chargeable on the bankrupt, or his representatives." 2 W. Blackstone, *Commentaries on the Laws of England* 488. *See generally* 3A COLLIER ON BANKRUPTCY (14th Ed.) ¶ 63.16 at 1858-60.

[30] The "absolute priority rule" has long been interpreted to require full compensation to creditors, including the interest on their claims to the date of payment, before the equity interests recover anything. *Group of Institutional Investors vs. Chicago,*

(Continued on following page)

(Continued from previous page)

Milwaukee, St. Paul and Pacific Railway Company, 318 U.S. 523, 87 L.Ed. 959, 63 S.Ct. 727 (1943); *Consolidated Rock Products Company vs. DuBois,* 312 U.S. 510, 85 L.Ed. 982, 61 S.Ct. 675 (1941). This principle was acknowledged in *Vanston Bondholders Protective Committee vs. Green, supra,* 329 U.S. at 164 ("But where an estate was ample to pay all creditors and to pay interest even after the petition was filed, equitable considerations were invoked to permit payment of this additional interest to the secured creditor rather than to the debtor.").

[31] *E.g., In re Macomb Trailer Coach, Inc.,* 200 F.2d 611, 613 (6th Cir. 1952), *cert. den'd sub nom. McInnis vs. Weeks,* 345 U.S. 958, 97 L.Ed. 1378, 73 S.Ct. 940 (1953); *Littleton vs. Kincaid,* 179 F.2d 386 (4th Cir. 1950); *Peoples Homestead Association vs. Bartlette,* 33 F.2d 561 (5th Cir. 1929); *Coder vs. Arts,* 152 F. 943 (8th Cir. 1907), *aff'd,* 213 U.S. 223, 245, 53 L.Ed. 772, 29 S.Ct. 436 (1909). This principle was also acknowledged by this Court in *Vanston Bondholders Protective Committee vs. Green, supra,* 329 U.S. at 156 ("Simple interest on secured claims accruing after the petition was filed was denied unless the security was worth more than the sum of principal and interest due.").

[32] In *Sexton vs. Dreyfus,* 219 U.S. 339, 346, 55 L.Ed. 244, 246, 31 S.Ct. 256 (1913), this Court relied upon the English rule in holding that interest and dividends accrued on the security after the date of the petition should be applied to interest on the secured debt accruing after the petition. *See also City of New York vs. Saper,* 336 U.S. 328, 330 n.7, 93 L.Ed. 710, 69 S.Ct. 554 (1949); *In re Black Ranches, Inc.,* 362 F.2d 8, 15 (8th Cir. 1966); *Beecher vs. Leavenworth State Bank,* 192 F.2d 10, 14 (9th Cir. 1951).

[33] As this Court explained in *Vanston Bondholders Protective Committee vs. Green, supra,* 329 U.S. at 165, "the touchstone

(Continued on following page)

These principles allowing for the revival of the right to post-petition interest were not repealed in the Bankruptcy Code, at least not with respect to secured creditors.[34] Bankruptcy Code section 506 is directed to the secured creditor, and includes provisions governing the status of secured claims and the valuation of security. Section 506 operates in two ways to allow secured creditors to recover post-petition interest in those circumstances in which they could have recovered such interest under the Bankruptcy Act.[35] In the first place, section 506(a) divides the claim of a secured creditor into two portions—a secured claim to the extent of the value of the creditor's interest in property, and an unsecured claim to the extent of any deficiency. The "value" of the creditor's interest in property has an expansive meaning left to judicial interpretation, and is intended to allow secured creditors to receive "the benefit of their bargain." *See infra* at 25-27, 33-34. If value under section 506(a) is interpreted, as is value under section 361, to include the time value of the creditor's interest in property, then the secured portion of the creditor's claim increases by the amount that could be earned by liquidating the collateral and reinvesting the proceeds; thus, the allowed secured claim will increase to the same extent as the creditor receives periodic post-petition payments or other protection for its interest in property.

In the second place, section 506(b) specifically allows the secured creditor to recover interest to the extent that the value of its security is greater than the amount of its claim. Section 506(b), unlike section 506(a), refers to the value of the property securing the creditor's claim rather than the value of the creditor's interest in that property. In practice, however, the operation of section 506(b) allows the secured creditor to recover post-petition interest when the creditor has been adequately protected for the time value of its interest during the pendency of the case; this protection will decrease the allowed claim (if periodic payments are made) or will increase the value of the security (if an additional lien, equity cushion or other protection is required), in either case increasing the value of the property relative to the claim.[36]

(Continued from previous page)

of each decision on allowance of interest in bankruptcy, receivership and reoganization has been a balance of equities between creditor and creditor or between creditors and the debtor." The above-described principles allowing for the recovery of post-petition interest are not hard and fast rules, but instead are general principles to guide the bankruptcy court in the exercise of equity. Therefore, these principles have not been treated as the exclusive basis for the allowance of post-petition interest, nor have they been applied to automatically assure post-petition interest. *See Smith vs. Robinson*, 343 F.2d 793, 800-801 (4th Cir. 1965); *In re Magnum Harmonica Corporation*, 262 F.2d 515, 518 (3rd Cir. 1959); *In re Leeds Homes, Inc.*, 222 F.Supp. 20 (E.D. Tenn. 1963), *aff'd*, 332 F.2d 648 (6th Cir. 1964).

[34] It has been suggested that Congress inadvertently failed to allow for the revival of post-petition interest for unsecured creditors, or that Congress inadvertently limited such interest to "the legal rate" in Bankruptcy Code section 726(a)(5). *See In re United Merchants and Manufacturers, Inc.*, 674 F.2d 134, 138 (2nd Cir. 1982); C. Fortgang and L. King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions*, 56 N.Y.U.L.REV. 1148, 1149-65 (Nov.-Dec. 1981).

[35] The legislative history does not express an intent to codify principles allowing for the revival of post-petition interest, nor does it express an intent to repeal them. The House and Senate Reports are silent concerning these principles in their discussions of Bankruptcy Code section 506. *See* House Report at 356-57; Senate Report at 68. The court below, 793 F.2d at 1387 n.8, misquotes the Senate Report as stating an intent to codify current law in section 506(b), by giving the oversecured creditor interest to the value of its collateral; the Senate Report does not mention interest, but refers only to the statute's treatment of "fees (including attorneys fees), costs and charges." Senate Report at 68.

---

[36] If one assumes (as did the court below) that absent section 506(b) the secured creditor can recover no more than its allowed claim, calculated as of the date the petition is filed, then periodic post-petition payments must be applied against that

(Continued on following page)

It is therefore clear that the drafters of the Bankruptcy Code did not intend, and that Bankruptcy Code section 506 does not operate, to repeal longstanding principles allowing for the revival of post-petition interest to secured creditors in situations where equity demands. But section 506 does not define these situations, instead relying on a concept of value that was intentionally left to case-by-case development. It is therefore appropriate to look for guidance in those principles, developed through many years of practice under the Bankruptcy Act and previous statutes, that allowed for the recovery of post-petition interest.[37]

Courts have long allowed secured creditors to recover post-petition interest not only when the value of their

---

(Continued from previous page)

claim. This is clear from cases in which periodic payments are made to compensate the secured creditor for the depreciation of its collateral; unless these payments are applied to the allowed claim (presumably to the secured portion), the total amount of the claim will remain constant and, if payment is made on the unsecured portion, the creditor in effect will have receive more than its allowed secured claim and therefore will have recovered post-petition interest. When the periodic payments are applied to the allowed claim, that claim will be less at the time a plan is confirmed than at the time the petition was filed. Where the security is not depreciating, and the creditor has been compensated only for the costs of delay, the value of the security at the time of confirmation will remain the same. To the extent that the value of the security exceeds the amount of the allowed claim (which has been paid down by the periodic post-petition payments), section 506(b) will allow the secured creditor to recover post-petition interest.

[37] *See, e.g., Birmingham Trust National Bank vs. Case*, 755 F.2d 1474, 1476 (11th Cir. 1985) (relying on judicial interpretation of non-dischargability provisions in the Bankruptcy Act, as a guide to interpreting the same in the Bankruptcy Code); *Atkins vs. United States*, 556 F.2d 1028, 1039-40 (Ct.Cl. 1977), *cert. denied*, 434 U.S. 1009, 54 L.Ed. 751, 98 S.Ct. 718 (1978) (noting the "cardinal principle" that "in the absence of a clearly expressed intent to the contrary, the revision or recodification of a statute indicates approval of court interpretation of the statute made prior to the reenactment").

security is sufficient to recover such interest, but also where the security itself generates interest, dividends or other income during the pendency of the case. *See infra* at n. 32. In this case, the security is improved real estate held for speculative purposes; the debtor concedes that it has no equity in the property at its current market value, and seeks to retain the property in the optimistic hope that this value will substantially increase. In holding this speculative asset, the debtor is giving up a current return that could have been earned on the reinvested proceeds had the property been sold in the current market; the debtor has chosen to retain the property for its own speculative purposes, and imposes an opportunity cost in doing so. It is not unreasonable to require the debtor to pay for this use of the secured creditor's collateral, just as the debtor must pay for the use of property it leases.[38] The debtor's payment for this use (through periodic post-petition payments, not unlike post-petition rentals for the use of the leased property) would be the real income of the property and a reasonable basis for post-petition interest.

The allowance of post-petition interest in a case such as this also follows from this Court's primary holding in *Sexton v. Dreyfus, supra.* The Court held that post-petition interest on a secured claim was not payable in that case, but the holding must be understood in the context of the law as it existed at that time. Under section 57(h) of the Bankruptcy Act, 11 U.S.C. § 93(h) (repealed 1978), the secured creditor (a pledgee in possession of the collateral) was entitled to liquidate its security at any time, whereupon the creditor could prove its claim for the deficiency, if any, remaining after the sale of the collateral. The secured creditor in *Sexton* had purposefully delayed liquidating its collateral; after selling the collateral, the creditor sought to apply the proceeds first to post-petition interest, leaving a deficiency to be proved as an unsecured claim. It is because the delay was the choice of the secured creditor, and operated to its benefit, that the Court denied interest.[39] The rationale of the *Sexton* decision is not that post-petition interest is not allowable; it is, instead, that neither secured creditor nor debtor should profit from delay.[40] Thus, while the Court denied post-petition interest to the creditor who delayed liquidating its security, the Court also allowed interest to be paid out of the post-petition income of the security: "There is no more reason for allowing the bankrupt estate to profit by the delay beyond the day of settlement than there is for letting the creditors do so." 219 U.S. at 346.

---

[38] The debtor must pay post-petition rentals, on a timely basis, for non-residential real property it continues to lease after the petition is filed. 11 U.S.C. § 365(d)(3). On all other leases, the debtor must pay, as an administrative expense, fair market value rent until such time as the lease is accepted or rejected. *See* 11 U.S.C. § 503(b); 2 Cowans, BANKRUPTCY LAW AND PRACTICE (1986 ed.) § 12.15 at 439.

This case is, at base, the obverse of the primary holding of the *Sexton* Court. In this case, it is the debtor that has control over the date by which the security will be liquidated. Since it is the debtor's choice to retain the property, in the speculative hope that its value will increase, the debtor will profit from its own delay unless it compensates the secured creditor for the income lost by the delay. The debtor has, in effect, chosen to use the security for its own purpose—speculation—during the pendency of the bankruptcy case, and this speculative use of property has a value measured by the income that could have been earned on the reinvested collateral proceeds. If the lesson of *Sexton* is to be heeded, the secured creditor must be compensated for the loss of this value. Periodic post-petition payments to protect the secured creditor, even if considered interest, are therefore consistent with, if not required by, longstanding principles allowing for the revival of post-petition interest in reorganization cases.

IV.

CONCLUSION: PROTECTION FOR THE COSTS OF DELAY AND THE POLICIES OF THE BANKRUPTCY CODE

The Bankruptcy Code has expanded the trustee's or debtor's authority to use property subject to a lien—especially in cases where the bankruptcy estate has no equity in the property. Under prior law, a secured creditor was almost invariably entitled to relief from the stay to enforce its rights in property in which the estate had no equity. By statutorily authorizing the court to condition the use of such property on adequate protection, the Code facilitates the continuation of the automatic stay. A bankruptcy court may now continue the stay despite the absence of any value that can be saved for the debtor and its unsecured creditors, so long as the continued stay is conditioned on "adequate protection" of the secured creditor's interest in the property.

Bankruptcy Code sections 362(d) and 361 were intended not only to expand the authority to use property subject to a lien, but also to protect the secured creditor from this expanded power. The secured creditor's protection is the requirement, which runs throughout these sections, that the value of the creditor's interest in property be adequately protected. The Code does not define the value that is to be protected, and Congress expressed the clear intent that this value be left to judicial development. But the court below concluded that this protection is necessarily limited to depreciation in the value of the creditor's collateral. Because the legislative history of the Code does not address protection of the time value of secured creditors' rights, the court below afforded no protection for the undeniable loss suffered by secured creditors (as well as others with interests in property of the estate) who are stayed for some period of time from enforcing their rights in property. So long as the property is not deteriorating or depreciating, the holding of the court below allows the indefinite use even of property in which the trustee or debtor has no equity.

---

[39] The Court explained: "When there is a delay in selling [the collateral] because of the hope of getting a higher price, it is more for the advantage of the secured creditor than of anyone else, as he takes the whole advance, and the others only benefit by a percentage, which does not seem a good reason for allowing him to prove for interest by indirection." 219 U.S. at 345.

[40] *See also In re Macomb Trailer Coach, supra,* 200 F.2d at 614 (allowing post-petition interest to the secured creditor in part because the delay in payment was the result of legal proceedings that the secured creditor had a right to invoke).

This refusal to recognize the time value of rights in property raises an important rhetorical question: When (if ever) will an undersecured creditor whose collateral is not depreciating be entitled to relief from the stay to enforce its rights? If the court below is correct, such a creditor is *never* entitled to such relief, no matter for how long it may be deprived of its collateral. Of course, this does not concern those who oppose protection of the time value of secured creditors' rights. Like the Respondent in this case, they argue that the Bankruptcy Code provides ample protection for the creditor against delay by the debtor. These protections against delay include the right to move for dismissal of the case "for unreasonable delay by the debtor that is prejudicial to creditors," under Bankruptcy Code section 1112(b)(3), 11 U.S.C. § 1112

(b)(3); the right to file a creditor's plan liquidating the debtor, under section 1121(c), 11 U.S.C. § 1121(c), if the debtor files no plan and the court grants no extension to the debtor; and the right to move for appointment of a trustee, under section 1104, 11 U.S.C. § 1104, if the debtor is guilty of "fraud, dishonesty, incompetence, or gross mismanagement."

These draconian provisions do afford some protection against unreasonable delay in extreme circumstances, where a debtor is unable or refuses without justification to propose a plan or where a debtor is mismanaging the estate. But these provisions cannot provide any meaningful protection to the undersecured creditor in the ordinary business reorganization case. These provisions do not require dismissal or liquidation because of delay *per se*, and set no standard for judging the reasonableness of the time taken to propose and confirm a plan. Without a standard requiring protection of the time value of the secured creditor's rights, there is little to guide the bankruptcy court in determining what is and is not a reasonable period of time. Is it reasonable, for example, for the debtor to indefinitely retain speculative assets, so long as they are not depreciating in value, in the hope that their value may eventually rise with the market? Is it reasonable to do so for one year? Or for five years? Or is it reasonable to indefinitely hold an apartment project (as has the Respondent for over two years so far) while waiting for an upturn in the local economy? The court below ultimately leaves these questions to each individual bankruptcy judge, who must decide without meaningful guidance whether a debtor is guilty of "unreasonable delay."

Moreover, these provisions allowing dismissal or liquidation on a creditor's motion are extreme and drastic remedies. Most business reorganizations involve not a single secured creditor, but *many* creditors and numerous *classes* of creditors. It is unreasonable to expect the court to dismiss a large case or liquidate a debtor because of a single undersecured creditor's complaint. In the ordinary reorganization involving multiple assets, the undersecured creditor would be left at the mercy of the larger body of creditors. Most creditors are unsecured, and some are oversecured, and in either event are harmed less by delay than is the undersecured creditor.

The fact remains that a secured creditor, whether oversecured or undersecured, has an interest in property of the bankruptcy estate. That interest has a value that is measured, in part, by the time it takes to exercise rights in the property. Unless the time value of the secured creditor's rights is adequately protected, the secured creditor is left without meaningful protection of its interest in property. The Petitioner therefore prays that this Court reverse the holdi~~ng~~ of the court below and remand for proceedings consistent with such reversal.

Respectfully submitted,

*H. MILES COHN
SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe Plaza, Suite 1700
Houston, Texas 77057
(713) 785-1700

Attorneys for Petitioner

*Counsel of Record

AMICUS CURIAE
BRIEF

Supreme Court, U.S.
FILED
AUG 3 1987
JOSEPH F. SPANIOL, JR.
CLERK

⑥

No. 86-1602

In the Supreme Court of the United States

OCTOBER TERM, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS, PETITIONER

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

CHARLES FRIED
Solicitor General

RICHARD K. WILLARD
Assistant Attorney General

LOUIS R. COHEN
Deputy Solicitor General

ROY T. ENGLERT, JR.
Assistant to the Solicitor General

ROBERT S. GREENSPAN
ROBERT K. RASMUSSEN
Attorneys

Department of Justice
Washington, D.C. 20530
(202) 633-2217

32PP

QUESTION PRESENTED

Whether the requirement of 11 U.S.C. (& Supp. III) 361 and 362(d)(1) that a secured creditor receive "adequate protection" of its "interest" in property during the pendency of the automatic stay in bankruptcy includes protection for the time value of the proceeds that the creditor would have received on foreclosure.

TABLE OF CONTENTS

Page

Interest of the United States ... 1

Statement ... 2

Summary of argument ... 3

Argument:

- "Adequate protection" of a secured creditor's "interest" in property during the pendency of the automatic stay in bankruptcy includes protection for the time value of the proceeds the creditor would otherwise have received on foreclosure ... 5
  - A. The language of Sections 361 and 362 supports including protection for the time value of hypothetical foreclosure proceeds ... 6
    - 1. The phrases "adequate protection" and "indubitable equivalent" ... 8
    - 2. The phrase "interest" in property ... 11
  - B. The purpose of the automatic stay and its relationship to the reorganization provisions of the Bankruptcy Code support recognition of the time value of the secured creditor's foreclosure right ... 13

Conclusion ... 25

TABLE OF AUTHORITIES

Cases:

Butner v. *United States*, 440 U.S. 48 (1979) ... 12

CFTC v. *Weintraub*, 471 U.S. 343 (1985) ... 12

Cartwright Land Associates, In re, 3 Bankr. 277 (Bankr. S.D.N.Y. 1980) ... 11

Case v. *Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) ... 11

Kelly v. *Robinson*, No. 85-1033 (Nov. 12, 1986) ... 4, 14

Murel Holding Corp., In re, 75 F.2d 941 (2d Cir. 1935) ... 4, 9, 10, 11

Ohio v. *Kovacs*, 469 U.S. 274 (1985) ... 12

Schwab Adams Co., In re, 463 F. Supp. 8 (S.D.N.Y. 1978) ... 11

Vanston Committee v. *Green*, 329 U.S. 156 (1946) ... 12

Statutes:

Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911-922 ... 9
  48 Stat. 912 (§ 77B) ... 9
  48 Stat. 914 (§ 77B(b)(5)) ... 9

Statutes—Continued: Page

Bankruptcy Act of 1898, 11 U.S.C. (1976 ed.) 1 *et seq.* (repealed 1979) 9
  11 U.S.C. (1976 ed.) 616(7) 11
Bankruptcy Code, 11 U.S.C. (& Supp. III) 101 *et seq.* 6
  Ch. 3, 11 U.S.C. (& Supp. III) 301 *et seq.*:
    11 U.S.C. (& Supp. III) 361 .... *passim*
    11 U.S.C. (& Supp. III) 361(1) 6, 7
    11 U.S.C. (& Supp. III) 361(2) 6, 7
    11 U.S.C. (& Supp. III) 361(3) 6, 7, 8, 10
    11 U.S.C. (& Supp. III) 362 .. 2, 4, 5, 6, 10, 11, 18, 22
    11 U.S.C. (& Supp. III) 362(a) 2, 14
    11 U.S.C. (& Supp. III) 362(d) 14
    11 U.S.C. (& Supp. III) 362(d)(1) 2, 6, 7, 8
    11 U.S.C. (& Supp. III) 362(d)(2) 11
    11 U.S.C. (Supp. III) 362(e) 23
    11 U.S.C. (& Supp. III) 365 23
  Ch. 5, 11 U.S.C. (& Supp. III) 501 *et seq.*:
    11 U.S.C. (& Supp. III) 502 13
    11 U.S.C. (Supp. III) 502(b)(2) 20
    11 U.S.C. (& Supp. III) 503(b)(1)(A) 19
    11 U.S.C. (& Supp. III) 503(b)(3) 19
    11 U.S.C. 506(a) 16, 18, 21
    11 U.S.C. (Supp. III) 506(b) 20, 21, 22
    11 U.S.C. (& Supp. III) 507 1
    11 U.S.C. 507(a)(1) 19
    11 U.S.C. 507(b) 19
  Ch. 7, 11 U.S.C. (& Supp. III) 701 *et seq.*:
    11 U.S.C. (Supp. III) 725 19
    11 U.S.C. (& Supp. III) 726 19
    11 U.S.C. 726(a)(5) 20, 21, 22
  Ch. 11, 11 U.S.C. (& Supp. III) 1101 *et seq.* 2, 4, 14, 16
    11 U.S.C. (& Supp. III) 1124(2) 22
    11 U.S.C. (& Supp. III) 1129 10
    11 U.S.C. 1129(a)(7)(A)(ii) 21
    11 U.S.C. (& Supp. III) 1129(b)(2)(A) 15
    11 U.S.C. 1129(b)(2)(A)(i)(II) 16
    11 U.S.C. 1129(b)(2)(A)(iii) 10

Miscellaneous:

Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97 (1984) 17

Miscellaneous—Continued: Page

3 *Collier on Bankruptcy* (15th ed. 1987) 16

H.R. Rep. 95-595, 95th Cong., 1st Sess. (1977) 10, 13, 14, 17, 19

Hill, *The Erie Doctrine in Bankruptcy*, 66 Harv. L. Rev. 1013 (1953) 12

Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857 (1982) 17

Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 Am. Bankr. L.J. 399 (1986) 24

Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. Chi. L. Rev. 305 (1983) 22

S. Rep. 95-989, 95th Cong., 2d Sess. (1978) 10, 19, 20

U.C.C. §§ 9-504 to 9-506 (1985 & Supp. 1986) 13

In the Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1602

UNITED SAVINGS ASSOCIATION OF TEXAS, PETITIONER

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

The United States and its agencies are often creditors in bankruptcy reorganization proceedings. For example, the Internal Revenue Service is a creditor in a very high percentage of such proceedings because of federal taxes owed by the debtor. Other agencies, such as the Farmers Home Administration of the Department of Agriculture and the Small Business Administration, make loans to private parties, some of which enter bankruptcy before repaying the loans. Still other agencies, such as the Federal Deposit Insurance Corporation, become creditors in reorganization proceedings because of the failure of entities they insure. Some of the claims of federal entities against debtors in reorganization are secured or partially secured; others are unsecured but entitled to a priority under 11 U.S.C. (& Supp. III) 507; and others are unsecured, nonpriority claims. The question presented by this case affects the rights of creditors vis-à-vis debtors and vis-à-vis each other. The United States therefore has an interest in the proper resolution of that question.

STATEMENT

This is a one-asset bankruptcy reorganization case. Respondent's only asset, an apartment project in Houston, is the security for a loan in the original principal amount of $4,100,000 made by petitioner in June 1982 (Pet. App. 57a). Respondent defaulted on the loan, and petitioner took action to foreclose on the apartment project, but one day before the foreclosure sale respondent filed a petition under Chapter 11 of the Bankruptcy Code, 11 U.S.C. (& Supp. III) 1101 *et seq.* (Pet. App. 57a-58a). The filing of the petition automatically stayed petitioner's attempts to foreclose under state law (11 U.S.C. (& Supp. III) 362(a)).

On a secured creditor's request, the bankruptcy court must grant relief from the automatic stay imposed by Section 362 if the debtor does not provide "adequate protection" of the creditor's "interest in property" of the debtor (11 U.S.C. (Supp. III) 362(d)(1)). Petitioner sought such relief. The bankruptcy court held a hearing and determined that, on the date of the hearing, respondent owed petitioner more than $4,300,000 in principal and accrued prepetition interest but that the value of the apartment project was only $4,250,000 (Pet. App. 58a, 155a). The court also found that the value of the property was not depreciating but was appreciating, if at all, "*very* slightly" (*id.* at 144a (emphasis in original)).

The bankruptcy court held that petitioner was entitled to "adequate protection" even though the value of the apartment project was stable. The court recognized that, because of the automatic stay, petitioner had lost the opportunity to foreclose under state law and to reinvest the proceeds (Pet. App. 144a-147a). Under 11 U.S.C. (& Supp. III) 361, the court ordered respondent to pay petitioner $42,500 per month as compensation for its lost opportunity to reinvest the proceeds of a foreclosure sale, or have the automatic stay lifted.[1] The district court affirmed (Pet. App. 136a-138a).

The court of appeals reversed. A panel first held that "Congress did not intend to provide undersecured creditors with periodic postpetition interest payments on the value of their collateral as an element of adequate protection" (Pet. App. 55a-56a). The panel therefore reversed "to the extent that it ordered [respondent] to pay $42,500 monthly for 'adequate protection of foreclosure rights' " (*id.* at 133a). The court granted rehearing en banc on the day the panel opinion was released (*id.* at 134a-135a) but eventually voted ten to five to reinstate the panel opinion (*id.* at 1a-52a).

SUMMARY OF ARGUMENT

In this case the Court must interpret what Congress meant, in the adequate protection sections of the Bankruptcy Code, when it referred to the secured creditor's "interest" in property. The court of appeals interpreted the adequate protection sections to mean that the creditor is protected only against the risk that the value of the physical property will decline. But the value of the physical property does not measure the secured creditor's "interest" in its collateral. Rather, the secured creditor's "interest" is its contract and state-law right to foreclose on the collateral on default – an interest whose value declines when the power to exercise the right is delayed.

This interpretation of the statutory term "interest" in property is supported by the pre-Code usage of the terms

---

[1] Petitioner and respondent had previously agreed that respondent would pay petitioner the net income produced by the apartment complex. The bankruptcy court held that such payments should be applied against the required monthly payment of $42,500 (Pet. App. 153a-154a).

"adequate protection" and "indubitable equivalent," which now appear in Sections 361 and 362 of the Code. "Adequate protection," a term first used by Congress in 1934, has been interpreted ever since the decision in *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935), to recognize the value of the creditor's right to foreclose at a particular moment. "Indubitable equivalent" is a phrase that was coined in that case precisely to refer to recognition of that value (75 F.2d at 942). The context in which those terms are used in Sections 361 and 362 is not the same as the context in which they were applied in *Murel Holding*, but there is no reason to believe that when Congress imported them into Sections 361 and 362 it did not intend them to be given their traditional meanings.

Likewise, the phrase "interest" in property is most naturally read to refer not to a fractional share of the physical property but to the bundle of rights created by the creditor's contract and by state law. The central right a secured creditor enjoys is the right to foreclose on the collateral to obtain payment of a defaulted debt. Delaying the exercise of that right decreases the value of the creditor's "interest," whether or not the property itself is depreciating in value.

The "provisions of the whole [bankruptcy] law, and * * * its object and policy" (*Kelly* v. *Robinson*, No. 85-1033 (Nov. 12, 1986), slip op. 6 (original quotation marks and citations omitted)), also support reading Sections 361 and 362 to recognize the time value of hypothetical foreclosure proceeds. Corporate reorganization proceedings under Chapter 11 exist to determine whether the assets are worth more as parts of a going concern than in piecemeal liquidation, and if so to capture that extra value. The automatic stay ensures that there is time to make that determination and act on it, but the adequate protection provisions exist to ensure that the losses caused by the automatic stay do *not* rest with the secured

creditors. That is because secured creditors generally are not the beneficiaries of successful reorganization; rather, it is unsecured creditors who enjoy the benefit of successful reorganization, and the Code therefore requires them to bear the costs of reorganization. It is plainly the purpose of Sections 361 and 362 to relieve secured creditors of costs of reorganization. The administrative expense provisions of the Code likewise place costs of reorganization on the unsecured rather than the secured creditors. And the postpetition interest provisions of the Code, which protect the time value of the rights of both *over*secured creditors and (in some instances) *un*secured creditors, cannot rationally be read to imply that the adequate protection provisions of the Code must in all instances ignore the time value of the rights of *under*secured creditors. Rather, a reading of Sections 361 and 362 that recognizes the time value of the foreclosure rights of all secured creditors—oversecured or undersecured—most sensibly reconciles all of these provisions of the Code.

ARGUMENT

"ADEQUATE PROTECTION" OF A SECURED CREDITOR'S "INTEREST" IN PROPERTY DURING THE PENDENCY OF THE AUTOMATIC STAY IN BANKRUPTCY INCLUDES PROTECTION FOR THE TIME VALUE OF THE PROCEEDS THE CREDITOR WOULD OTHERWISE HAVE RECEIVED ON FORECLOSURE

Although we believe that the language and portions of the legislative history of the adequate protection requirement support including protection for the time value of the proceeds of a foreclosure that would have occurred but for the automatic stay, neither the statute nor its legislative history addresses this question explicitly. When the statutory language is read in light of the nature of a secured creditor's interest in property and the purpose of the automatic stay, however, we believe the argument for reading it to include such time value becomes compelling.

A. The Language of Sections 361 and 362 Supports Including Protection for the Time Value of Hypothetical Foreclosure Proceeds

This is a statutory interpretation case. Although other provisions and the structure of the Bankruptcy Code, 11 U.S.C. (& Supp. III) 101 *et seq.*, are relevant, the statutory phrases that the Court must interpret are found in only four subsections. The first is 11 U.S.C. (Supp. III) 362(d)(1), which provides (emphasis added):

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
>
> > (1) for cause, including the lack of adequate protection of *an interest in property* of such party in interest * * *.

The other three subsections to be interpreted are all found in 11 U.S.C. (& Supp. III) 361 (emphasis added):

> When adequate protection is required under section 362 * * * of this title of an *interest of an entity in property*, such adequate protection may be provided by—
>
> > (1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title * * * results in a decrease in *the value of such entity's interest in such property;*
> >
> > (2) providing to such entity an additional or replacement lien to the extent that such stay * * * results in a decrease in *the value of such entity's interest in such property;* or
> >
> > (3) granting such other relief, other than entitling such entity to compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of *the indubitable equivalent of such entity's interest in such property.*

All four of the subsections to be construed refer to the creditor's "interest" in property. Section 362(d)(1) requires "adequate protection" of that "interest." Subsections (1) and (2) of Section 361 specify means of protection against decreases in the "value" of that "interest." Subsection (3) permits other means of adequate protection but requires that they result in the realization of the "indubitable equivalent" of that "interest." It seems clear that each of the four subsections refers to the same thing when it speaks of the creditor's "interest" in property.[2]

The court of appeals interpreted the four subsections to require protection only against the risk that the value of the physical property—here, the apartment project—would decline to such an extent as to reduce the number of dollars the creditor would eventually receive on foreclosure. Under that interpretation, the "value" of a creditor's "interest" never decreases for purposes of Section 361(1) and (2) unless the value of the property itself decreases, and the creditor receives the "indubitable equivalent" of its "interest" for purposes of Section 361(3) as long as it is assured that the value of the property itself does not decrease.

---

[2] For this reason, if any one of the four subsections assigns a clearly discernible meaning to the creditor's "interest" in property, it is logical to conclude that all four subsections assign that same meaning. The court of appeals thought that the meaning of "interest" in property could most clearly be determined from the language of subsections (1) and (2) of Section 361 (see Pet. App. 70a) and then reached the logical conclusion that Section 361(3) did not mean anything different. We submit, however, that it is very far from clear that subsections (1) and (2) have the meaning that the court of appeals assigned to them and that it is in subsection (3) that Congress has—through use of the phrase "indubitable equivalent"—most clearly indicated what "interest" in property was to be protected. See pages 8-10, *infra*. Because subsection (3) assigns an unambiguous meaning to the "interest" that is to be protected, it is that unambiguous meaning that should guide interpretation of "interest" in subsections (1) and (2), and not vice versa.

But an ordinary secured creditor's "interest" in its collateral is *not* a fractional share of ownership, but a right, under its contract with the debtor and state law, to foreclose on the collateral on default and apply the foreclosure proceeds to the payment of the debt. That economically valuable right is temporarily blocked by the automatic stay. That "interest" of the creditor in the property constituting its collateral is not "adequate[ly] protect[ed]" under Section 362(d)(1) unless there is not only protection of the secured creditor's ability eventually to obtain the same number of dollars in foreclosure but also protection of its ability ultimately to collect the dollars that those proceeds would have earned if it had exercised its foreclosure right at the time it bargained for. The "value" of the creditor's foreclosure right decreases over time even when the value of the collateral is stable, because the right to collect a dollar a year from now is less valuable than the right to collect a dollar today; and the creditor receives the "indubitable equivalent" of its "interest" for purposes of Section 361(3) only if the rights granted the creditor recognize the time value of foreclosure proceeds.

1. The Phrases "Adequate Protection" and "Indubitable Equivalent"

This interpretation is supported by the traditional usage of the phrases "adequate protection" and "indubitable equivalent" before passage of the Code. "Adequate protection" had been held to *recognize* the time value of money, and "indubitable equivalent" was a term of art used precisely to *mean* recognition of the time value of the right to foreclose at a particular moment — a meaning that was quite clearly intended when the same phrase was used elsewhere in the Bankruptcy Code.

BEST AVAILABLE COPY

"Adequate protection" is a term imported by Congress from the plan confirmation context into the automatic stay context. Congress first used the term in 1934 (see Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911-922), when it added a new corporate reorganization provision (Section 77B) to the Bankruptcy Act of 1898. That provision permitted a plan of reorganization to be confirmed, over the objection of a class of creditors, only if the plan "provide[d] in respect of [that] class of creditors * * * adequate protection for the realization by them of the value of their interests, claims, or liens, if the property affected by such interests, claims, or liens is dealt with by the plan" (Section 77B(b)(5), 48 Stat. 914).

Within a year after the insertion of "adequate protection" into the Bankruptcy Act, the owners of an apartment building in default on their obligations made the same argument that respondent makes today: that "adequate protection" of the "value" of an "interest[ ], claim[ ], or lien[ ]" in property need not take account of time value. In the seminal case of *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935), the court disagreed. Judge Learned Hand wrote for the court (75 F.2d at 942):

> It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, but a creditor who fears the safety of his principal will hardly be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence.

Murel Holding thus interpreted the phrase "adequate protection," as it appeared in the Bankruptcy Act, to require provisions fully equivalent to the creditor's right to foreclose at a particular moment, and *Murel Holding* coined the phrase "indubitable equivalence" for the purpose of capturing precisely that concept.[3]

There is reason to believe that Congress intended, in the Code, to give these two phrases the meaning that Judge Hand had given them. In the context in which *Murel Holding* arose—the confirmation of a reorganization plan over the objection of a class of secured creditors (or "cramdown")—Congress no longer uses the phrase "adequate protection," but it has now used in the statute Judge Hand's phrase "indubitable equivalen[t]" (see 11 U.S.C. 1129(b)(2)(A)(iii)). That was deliberate. See S. Rep. 95-989, 95th Cong., 2d Sess. 127 (1978) ("The indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in *In re Murel Holding Corp.* * * *."); H.R. Rep. 95-595, 95th Cong., 1st Sess. 414 (1977) ("This contemplates a present value analysis that will discount value to be received in the future * * *."). There is, to be sure, no similarly precise recognition in the legislative history of Section 361(3) of the genesis of the "indubitable equivalent" language. But the repetition in Section 361 of such a peculiar phrase, which originated to capture the concept of the value of foreclosure at a particular moment and is still used with that meaning in Section 1129, certainly suggests that the phrase should be given the same meaning when it occurs in Section 361.[4]

---

[3] The court of appeals observed (Pet. App. 101a): "In 1978, Congress did codify the holding of *Murel*, as distinguished from its rhetoric, in the cram-down provisions of the Code." That is true. But Congress also codified the phrases "adequate protection" and "indubitable equivalen[t]"—what the court of appeals called *Murel*'s "rhetoric"—in Sections 361 and 362. Although the legislative history does not explain the source of the phrases as used in those sections, neither does it suggest that Congress meant them to be construed without reference to prior statutes and cases that employed them.

[4] Section 361(3) in its present form was contained in neither the bill as first passed by the House nor the bill as first passed by the Senate;

The phrase "adequate protection" has a comparable history. It was used in the cramdown section of the old Bankruptcy Act (see 11 U.S.C. (1976 ed.) 616(7)) and had a well-understood meaning, which included compensation for the time value of money, from the time of *Murel* up to passage of the Code in 1978. See, *e.g.*, *In re Schwab Adams Co.*, 463 F. Supp. 8, 12 (S.D.N.Y. 1978); *In re Cartwright Land Associates*, 3 Bankr. 277, 279 (Bankr. S.D.N.Y. 1980). Although there is again no legislative history specifically tying this phrase in Sections 361 and 362 to its antecedent interpretations, it would be surprising for Congress to use such a timeworn phrase, even in a new context, and intend that it mean something different from what it had meant under prior law. See *Case* v. *Los Angeles Lumber Products Co.*, 308 U.S. 106, 115 (1939) ("where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary").

2. The Phrase "Interest" in Property

Sections 361 and 362(d)(2) require "adequate protection" not of the value of property, but of the value of the secured creditor's "interest" in property. And a secured creditor's "interest" in property is not a fractional share of the physical property,[5] but a contract and state-law right to act in a particular manner against the property—to foreclose—in order to collect a debt that has gone into default.

---

the "conferees" added the "indubitable equivalent" language without explanation (see Pet. App. 97a-99a). But the best evidence of what Congress intended is the words used in the statute that Congress passed.

[5] This was apparently the view taken by the court of appeals. In its lengthy opinion, its only discussion of the meaning of the phrase "interest in such property" is a quotation of the statute followed by the statement "[c]learly neither subsection (1) nor (2) authorizes periodic payments to a creditor whose collateral is not decreasing in value" (Pet. App. 70a).

The Bankruptcy Code does not define the secured creditor's "interest" in its collateral, but the phrase necessarily refers to the bundle of rights created by contract and state commercial law. Bankruptcy law "generally [leaves] the determination of property rights in the assets of a [debtor's] estate to state law." *Butner* v. *United States,* 440 U.S. 48, 54 (1979) (footnote omitted); see also *Vanston Committee* v. *Green,* 329 U.S. 156, 170 (1946) (Frankfurter, J., concurring) ("[C]larity of analysis justifies repetition that except where federal law, wholly apart from bankruptcy, has created obligations by the exercise of power granted to the federal government, a claim implies the existence of an obligation created by State law.").[6]

A secured creditor's "interest" in its collateral consists centrally of the right, defined by its contract and state law, to force the collateral to be sold at a foreclosure sale on default in the debt, and to have the proceeds applied to payment of the debt. Procedures of course vary, and the secured creditor may have additional rights or may have only a limited or qualified right to force foreclosure. But, insofar as the automatic stay operates to stay a creditor's enjoyment of its interest in the collateral, it does so by staying foreclosure. Significantly, a secured creditor ordinarily may not, even on default, seize the property and enjoy the rights of an owner: in order to protect debtors, state law generally requires the creditor to proceed by way

---

[6] Indeed, it is a fundamental principle of bankruptcy law that it operates on substantive rights created outside of bankruptcy. See, *e.g., CFTC* v. *Weintraub,* 471 U.S. 343, 351-352 (1985) (corporation's attorney-client privilege controlled by actor whose role approximates that of management outside of bankruptcy); *Ohio* v. *Kovacs,* 469 U.S. 274, 286 (1985) (O'Connor, J., concurring) ("the classification of Ohio's interest as either a lien on the property itself, a perfected security interest, or merely an unsecured claim depends on Ohio law"); Hill, *The Erie Doctrine in Bankruptcy,* 66 Harv. L. Rev. 1013, 1035 (1953) ("apparent purpose" of federal bankruptcy laws is to provide a system for the effectuation of state-created rights).

of foreclosure sale, so that any value in excess of its debt is available for junior secured creditors or the debtor. See, *e.g.,* Uniform Commercial Code §§ 9-504 to 9-506 (1985 & Supp. 1986). (The secured creditor may, of course, become the owner of the property by being the high bidder at the foreclosure sale, but that is an ownership interest acquired by purchase at the time of foreclosure.) Congress was presumably aware of these textbook principles of creditors' rights when it enacted the Bankruptcy Code.

As illustrated by the present case, when the question of adequate protection arises, the debt owed to the secured creditor is generally in default, either because a default occurred before bankruptcy or because bankruptcy itself was an event of default.[7] And, as in the present case, the secured creditor generally has a matured right to foreclose on the collateral, which the automatic stay prevents it from exercising. In such a case, the stay plainly "results in a decrease in the value of [the creditor's] interest in such property": its interest *is* the right to foreclose against the property on default, and delaying its foreclosure, denying it the use of the foreclosure proceeds for a period of time, decreases the value of that interest.

B. The Purpose of the Automatic Stay and its Relationship to the Reorganization Provisions of the Bankruptcy Code Support Recognition of the Time Value of the Secured Creditor's Foreclosure Right

When interpreting a statute, a court "must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy." *Kelly* v. *Robinson,* No. 85-1033 (Nov. 12, 1986), slip op. 6 (original quotation marks and citations omitted). To whatever extent the phrase "adequate protection * * * of an interest of an entity in property" might be thought ambiguous standing alone, when the phrase is read in light of the purpose of the automatic stay in relation to the reorganization provisions of the Code, we believe the case for reading it to include the time value of the creditor's foreclosure right becomes compelling.

---

[7] Often, the terms of the debt specify that bankruptcy will be treated as an event of default. Furthermore, regardless of the terms of the debt, the Code—in particular 11 U.S.C. (& Supp. III) 502—generally treats bankruptcy as an event of default and acceleration. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 352-353 (1977) ("bankruptcy operates as the acceleration of the principal amount of all claims against the debtor").

The oft-stated purpose of corporate reorganization proceedings under Chapter 11 is to determine whether the assets of the debtor are worth more as parts of a going concern than in piecemeal liquidation and, if so, to reorganize so as to preserve that going-concern value. See, *e.g.*, H.R. Rep. 95-595, 95th Cong., 1st Sess. 220 (1977). If there is to be time to determine whether there is going-concern value, and if any such value is ultimately to be preserved, secured creditors must be prevented from foreclosing immediately on the separate assets in which they severally hold security interests. That is the function of the automatic stay provided in 11 U.S.C. 362(a).[8]

But for the adequate protection provisions of Section 362(d) and Section 361, the costs imposed on secured creditors by the automatic stay would rest where they fall.

---

[8] The present case is a poor illustration: the single asset, an apartment building, obviously has the same "liquidation" value as "going-concern" value. What this case does appear to illustrate is the misuse of Chapter 11. The relevant question about the one asset is, "Does it have any present value in excess of the debt it secures?" If not, then its value properly belongs wholly to the secured creditor. The appropriate way to answer the question would appear to be a foreclosure sale. Requiring the debtor to pay (or provide additional collateral to cover) the time value of the secured creditor's estimated foreclosure proceeds would at least prevent the debtor from gambling (on an upturn rather than a downturn in value) at the direct expense of the secured creditor. It would also curtail reorganization proceedings founded solely on the hope of such an upturn, rather than on the premise that reorganization would produce more value than liquidation.

The undisputed purpose of adequate protection is to force junior interests to bear at least some of these costs instead. The question in this case is whether the junior interests should bear not only the cost of depreciation or other decline in the value of the physical property over the stay period but also the costs of delay in exercise of the secured creditor's rights.

The underlying reason for providing adequate protection is one that applies equally to both costs: reorganization proceedings are carried on for the benefit of junior interests, and secured creditors should not have to bear their costs.[9] Secured creditors generally have nothing to gain and something to lose from the commencement and continuation of reorganization proceedings. Their claims are finite rather than residual. At the beginning of the proceedings, they have bargained-for rights against certain property, and at the end of the proceedings, adequate protection aside, their secured claims are bounded at the top by the same bargained-for rights in the same property (see 11 U.S.C. (& Supp. III) 1129(b)(2)(A)). But if the property has declined in value in the interim, or if their rights have been delayed, they suffer a real cost.

It is possible that the reorganization proceedings will increase the value of the secured creditor's collateral, but the chances are small, and the secured creditor has no assurance that it will benefit from any such increase.[10] The secured creditor receives no benefit unless the reorganization succeeds in preserving the going concern,[11] *and* the collateral itself has a value to the going concern that exceeds its liquidation value, *and* the plan of reorganization gives the creditor the benefit of that excess. But, first, the standard assumption is that, even when the enterprise is determined to have a going-concern value in excess of the aggregate liquidation value of its assets, the going-concern value of a given item of collateral will, in general, equal its liquidation value. See generally 3 *Collier on Bankruptcy* ¶ 506.04[2], at 506-30 to 506-33 (15th ed. 1987). Only those assets that are *uniquely* valuable in the hands of the debtor will be worth more to the reorganized enterprise than the highest bidder at a foreclosure auction will pay, and for obvious reasons creditors prefer security interests in property whose value is not unique to the particular debtor.

---

[9] The court of appeals took a directly contrary view, opining that reorganization in general is carried on for the benefit of secured creditors as well as junior parties (see Pet. App. 24a). The court of appeals never endeavored to explain why, in that case, Congress shifted *any* costs away from secured creditors to the junior parties – which is indisputably what the adequate protection provisions do.

[10] It is also possible that market conditions will change so as to increase the value of collateral during the proceedings, but that sort of increase is of course not a product of the proceedings. There is no good reason why a secured creditor should have to incur any cost on the chance that market conditions will increase the value of its collateral after the moment at which, under its contract, it would have been entitled to foreclose.

Moreover, the Code does not (as the court of appeals thought, Pet. App. 24a) routinely entitle the secured creditor to recognition, in a plan of reorganization, of the unique value of its collateral to the going concern. Section 1129(b)(2)(A)(i)(II) permits a plan to be crammed down on a class of secured creditors that receives "at least the value of [their] interest in the estate's interest in such property." Although it might well seem appropriate to interpret the term "value" in Section 1129(b)(2)(A)(i)(II) to mean full going-concern value, since the collateral is being used in a going concern and not liquidated,[12] Congress expressly indicated in the legislative history of Chapter 11 that it was *not* directing the bankruptcy courts to recognize going-

---

[11] Most reorganization attempts – roughly 90% – are not successful (see Pet. App. 25a n.17, 47a).

[12] Section 506(a) directs the bankruptcy court to determine the value of a creditor's interest in the estate's interest in property "in light of the purpose of the valuation and of the proposed disposition or use of such property."

concern value. See H.R. Rep. 95-595, 95th Cong., 1st Sess. 224 (1977) (footnote omitted) ("The question of whether creditors are entitled [on confirmation of a plan of reorganization] to the going-concern or liquidation value of the business is impossible to answer. It is unrealistic to assume that the bill could or even should attempt to answer that question. * * * The bill only sets the outer limits on the outcome: it must be somewhere between the going-concern value and the liquidation value."). Thus, although a bankruptcy court *could* insist that a plan of reorganization give secured creditors the benefit of going-concern rather than liquidation value in that rare case where the two diverge, the Code gives secured creditors no assurance that any bankruptcy court *would* do so. Secured creditors are by no means routine beneficiaries of successful reorganizations.

Conversely, unsecured creditors gain greatly from a successful reorganization. Most of the going-concern value that is captured by a successful reorganization is applied to their claims. See generally Baird & Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. Chi. L. Rev. 97, 105-109 (1984) (explaining different incentives of different types of creditors in bankruptcy proceedings).[13]

---

[13] The automatic stay and the adequate protection requirement also apply in a liquidating bankruptcy. Although the issue is much less important in that context, there too the automatic stay benefits unsecured creditors (whose interest lies in orderly distribution of the estate), not secured creditors (who bargained for the right to foreclose on specific assets and are temporarily barred from exercising that right). See generally Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857, 860-868 (1982) (describing the benefits that unsecured creditors obtain from a collective bankruptcy proceeding).

The court of appeals thought that Congress meant to deny secured creditors protection for the time value of their hypothetical foreclosure proceeds in order to make secured creditors bear some of the cost of delay associated with a reorganization proceeding, so that reorganization would be more likely to occur (see Pet. App. 108a, 112a, 120a). But the policy suggested by other provisions of the Bankruptcy Code is exactly the opposite: because in the usual case only unsecured creditors and equity owners stand to benefit from successful reorganizations, every provision that deals with the costs of delay seeks to protect secured creditors against those costs.[14]

First, as to Sections 361 and 362 themselves, the statutes, on their face, are designed to protect secured creditors, not to impose costs on secured creditors.[15]

---

[14] Of course, the Code treats undersecured creditors as *both* secured ("to the extent of the value of [the] creditor's interest in the estate's interest in" the collateral) and unsecured (to the remaining extent of the allowed claim). 11 U.S.C. 506(a). In their capacity as holders of unsecured claims, undersecured creditors do and should bear the costs of reorganization to the same extent as other holders of unsecured claims. But the fact that they must—as holders of unsecured claims—bear some of the costs of reorganization does not mean that they should bear *additional* costs in their capacity as secured creditors.

[15] An amicus brief filed in the court of appeals at the rehearing en banc stage put the point well (C.A. Br. for Amicus Curiae Thomas H. Jackson 18 n.18):

> The panel opinion * * * argues that "[t]here would be little economic incentive for the undersecured creditor . . . to cooperate in developing a negotiated plan." [Pet. App. 112a.] This elides the fact that such cooperation is not necessary, see 11 U.S.C § 1129(b). Such an argument, moreover, turns 11 U.S.C. § 361 upside down: it turns a section designed to *protect* secured creditors into a vehicle for *coercing* their cooperation (by imposing economic harm on them). The fact that, if time value were protected, delay "would have little adverse effect on the [secured] creditor," [Pet. App. 112a], presumably is the *point* of adequate protection: to keep those who will not benefit from reorganization from paying its costs.

See also Pet. App 34a n.5 (Jones, J., dissenting).

Nothing in the legislative history of those provisions suggests that Congress intended to impose costs on secured creditors. Rather, Congress intended to give secured creditors the "benefit of their bargain" in place of "an absolute right to [their] bargain." H.R. Rep. 95-595, 95th Cong., 1st Sess. 339 (1977); see also *ibid.* ("the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for"); S. Rep. 95-989, 95th Cong., 2d Sess. 53 (1978) (same two statements).[16] The legislative history gives some examples of adequate protection, and those examples fail to take account of the time value of money.[17] But nothing in the legislative history suggests that Congress affirmatively decided, contrary to the general purpose of Section 361, to impose on secured creditors a cost equivalent to the decline, over time, of the value of their foreclosure rights.

Second, other sections of the Bankruptcy Code dealing with costs of the proceeding place them squarely on junior parties. For example, administrative expenses, which are those expenses that are "necessary [to] preserving the estate" (11 U.S.C. (Supp. III) 503(b)(1)(A)) and include wages and attorneys' fees (see *ibid.*; 11 U.S.C. (& Supp. III) 503(b)(3)), are required to be paid after the secured creditors' claims are satisfied but before any other creditor receives anything from the debtor. See 11 U.S.C. (& Supp. III) 507(a)(1), 507(b), 725, 726. The assets subject to claims of secured creditors cannot be used to pay such costs.[18] This treatment of administrative costs is wholly inconsistent with the notion of the court of appeals that all parties should share in the costs of reorganization; it is consistent, however, with congressional recognition that it is junior classes who benefit from successful reorganizations and should bear their costs.

---

[16] These reports indicate a congressional intention that, *within bankruptcy*, Section 361 provide a secured creditor with the benefit of its bargain struck outside of bankruptcy. It is therefore wrong to suppose (see Pet. App. 129a-130a) that Congress meant to protect bargains struck outside of bankruptcy only to the extent that such bargains expressly precluded alteration by bankruptcy.

[17] See, *e.g.*, H.R. Rep. 95-595, *supra*, at 339 ("The use of periodic payments might be appropriate, where, for example, the property in question is depreciating at a relatively fixed rate. The periodic payments would be to compensate for the depreciation.").

Third, the treatment of postpetition interest in the Code—on which the court of appeals heavily relied—supports rather than refutes the proposition that Congress intended junior parties to participate in a reorganization only if secured creditors have received protection for the time value of the proceeds they would have received by exercising their rights. It is true, as the court of appeals noted, that no creditor—oversecured, undersecured, or unsecured—is allowed to include "unmatured interest" at the time of the petition in its claim. 11 U.S.C. (Supp. III) 502(b)(2). The court of appeals apparently inferred from this that all creditors, except an oversecured creditor receiving the benefit of 11 U.S.C. (Supp. III) 506(b),[19] lose forever the right to compensation for the delay that bankruptcy brings in the payment of their claims.

That is not true. Under 11 U.S.C. 726(a)(5), an *unsecured* creditor is entitled, on liquidation, to "interest

---

[18] Indeed, Congress explicitly rejected the proposal made in the House bill that debtors be allowed to provide adequate protection by granting the secured creditor an administrative expense. The rationale for this rejection was that "such protection is too uncertain to be meaningful." S. Rep. 95-989, *supra*, at 54.

[19] Section 506(b) provides:

> To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

at the legal rate from the date of the filing of the petition" before the debtor may receive anything. On confirmation of a plan of reorganization, the unsecured creditor is entitled (unless it consents to different treatment) to "receive or retain under the plan on account of [its unsecured] claim or interest property of a value * * * not less than the amount that such holder would receive or retain if the debtor were liquidated under chapter 7" (11 U.S.C. 1129(a)(7)(A)(ii)). Thus, if the assets of the estate are sufficient to allow equity holders to receive something from the estate even if the debtor were liquidated, then the unsecured creditor is entitled, in reorganization as in liquidation, to postpetition interest under Section 726(a)(5).

The construction of Section 361 adopted by the court of appeals brings about a bizarre state of affairs when the assets of the estate are sufficient to allow participation by equity holders even on liquidation.[20] In that situation, *over*secured creditors are entitled, on liquidation or on confirmation of a plan, to receive postpetition interest under Section 506(b) in recognition of the delay in enforcement of their rights, and *un*secured creditors are entitled to postpetition interest under Section 726(a)(5). But *under*secured creditors must—to the extent of their security—suffer the delay in enforcement of their rights without any compensation, since no section of the Code provides them with postpetition interest on the secured portion of their claims, and the construction of Section 361 adopted by the court below would not protect the time value of their security interest.[21] The *only* parties who have been forced to subsidize the bankruptcy proceeding are the undersecured creditors.

---

[20] It is, of course, rare for the assets of the estate to be sufficient for equity holders to participate in a distribution on liquidation, but the case in which they do so is expressly contemplated by the Code (11 U.S.C. 726(a)(6)).

[21] To the extent that the debtor owes an undersecured creditor more than the value of the collateral, however, the creditor has an unsecured claim (11 U.S.C. 506(a)). On that *unsecured* portion of the

The solution to this odd state of affairs is to accept the proposition—consistent with the words Congress has used in Sections 361 and 362—that the time value of the secured creditor's hypothetical foreclosure proceeds is part of the "interest" that must be "adequate[ly] protect[ed]." Thus, oversecured creditors are entitled to their Section 506(b) rights in all cases and are entitled to additional rights in cases in which the Section 506(b) rights are not sufficient to provide adequate protection.[22] See Pet. App. 39a-41a (Jones, J., dissenting); Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. Chi. L. Rev. 305, 321-322 (1983). And unsecured creditors, if the estate has sufficient assets to allow them to participate in full if the debtor were liquidated, will (either on liquidation or on reorganization) recover postpetition interest under Section 726(a)(5). By providing "adequate protection" in the form of additional liens that will entitle the undersecured creditor to have more of its claim allowed as a secured claim at the end of the proceeding—or by providing the equivalent in cash payments—Section 361 relieves the undersecured creditor of having to subsidize the proceeding.

---

debt, the creditor is entitled to postpetition interest under Section 726(a)(5) if the assets of the estate would be sufficient for the debtor to participate in a liquidation. Thus, a single creditor can—under the interpretation adopted by the court of appeals—receive interest on the portion of a debt that it did not protect by taking a security interest but be denied interest on the secured portion.

[22] For example, an oversecured creditor who made a loan at 3% interest but could recover 10% interest if it had been allowed to foreclose and reinvest the proceeds would be entitled to additional protection above and beyond its Section 506(b) rights (unless the debtor is able to reinstate the loan under 11 U.S.C. (& Supp. III) 1124(2)).

Nothing in the Code supports the perception of the court of appeals that Section 361 should, as a matter of policy, be read to limit rather than fully protect the economic rights of undersecured creditors. There is no general rule in bankruptcy—at least not under the Code—against the payment of postpetition interest, and there is most certainly no general rule that secured creditors must share with unsecured creditors the costs of reorganization.[23]

In sum, delay imposed by the automatic stay is a cost of the reorganization proceeding. By preventing the secured creditor from exercising its state-law rights, bankruptcy imposes a cost on the secured creditor. The value of its security interest is decreased both by the depreciation in its collateral during the bankruptcy proceeding and by the fact that the time when it can transform its security interest into cash has been extended into the future. Conversely, the debtor's estate appropriates any economic benefits of the automatic stay for itself. It is able to use this property to continue its operations.[24] The property left in the estate, like services purchased by the estate, is used in the hope that the reorganized entity will ultimately achieve more benefit from it than its cost—not, as the court of appeals thought, because the estate should be entitled to use property cost free in the hope that reorganization will ensue.[25] The uncompensated retention of a secured creditor's collateral by the estate would transfer wealth from the secured creditor to the estate for the benefit of unsecured creditors and/or the debtor. It would also create a strong and inappropriate incentive for debtors to enter and prolong reorganization solely in order to delay their secured creditors, when there is no real hope of preserving "going-concern" values. The congressional policy reflected in the Bankruptcy Code suggests that it is the junior parties, not the secured creditor, who should bear the cost of the estate's retention of the collateral.

---

[23] A different policy argument could be made. Adequate protection proceedings under 11 U.S.C. (Supp. III) 362(e) are required to be conducted promptly. It may be argued that it unduly complicates such proceedings to require that the bankruptcy court determine the time at which foreclosure could have been accomplished, the probable net proceeds to the creditor, and the rate at which those proceeds could have been invested. But assessment of the value of the tangible property and the likelihood of a decline in that value may also be a complex matter. With help from the parties, the court should be able—in cases where the continuation of the reorganization proceedings is warranted—to fashion means to protect the secured creditor's ultimate right to receive the benefit of its bargain.

[24] Thus, it seems appropriate that the estate should pay some form of rent to the secured creditor whose property it is using. Cf. 11 U.S.C. (& Supp. III) 365 (requiring administrative expense treatment of rents due under unexpired leases). According to the decision below, however, Congress must have intended that secured creditors be forced to leave the property securing their interests in the debtor's estate, rent free.

---

[25] "If it is indeed the case that the assets as a group are worth more together than apart, then it follows that the secured creditor can be given the value of its default rights—liquidation value—*in full* [meaning including time value] and still have something left over for the unsecured creditors. It is, indeed, tautological." Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 Am. Bankr. L.J. 399, 413-414 (1986) (footnote omitted).

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

RICHARD K. WILLARD
Assistant Attorney General

LOUIS R. COHEN
Deputy Solicitor General

ROY T. ENGLERT, JR.
Assistant to the Solicitor General

ROBERT S. GREENSPAN
ROBERT K. RASMUSSEN
Attorneys

AUGUST 1987

U.S. GOVERNMENT PRINTING OFFICE: 1987—181-483/40458

RESPONDENT'S

BRIEF

Supreme Court, U.S.
FILED
OCT 1 1987
JOSEPH F. SPANIOL, JR.
CLERK

(11)

No. 86-1602

In The
Supreme Court of the United States
October Term, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,
v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
d/b/a TIMBERS OF INWOOD FOREST
APARTMENTS, PHASE I,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENT

LEONARD H. SIMON
DAPHNE LEVEY
TIMOTHY J. HENDERSON
PENDERGRAFT, ELAM & SIMON
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
or call collect (402) 342-2831

BEST AVAILABLE COPY

59pp

QUESTION PRESENTED

What constitutes adequate protection of the interest of an undersecured creditor under 11 U.S.C. § 362(d)(1)?

LIST OF PARTIES

The list of parties submitted by the Petitioner in its Brief for Petitioner is correct except that W. B. Easter, Arthur C. Morales and Arden D. Christianson are not limited partners of the Respondent, but are guarantors of the note signed by Respondent in favor of the Petitioner.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

LIST OF PARTIES ii

TABLE OF CONTENTS iii

TABLE OF AUTHORITIES v

STATEMENT OF THE CASE 1

SUMMARY OF ARGUMENT 2

ARGUMENT 4

I. Introduction 4

II. The Language of Section 361 6

- A. The "Interest" to be Protected 6
- B. "Adequate Protection" and the "Indubitable Equivalent" 8
- C. The "Value" of the Interest 12
- D. Comparison with the Language Used in Section 1129 13

III. Legislative History 13

- A. Adequate Protection in the Legislative History 13
- B. The Silence of the Legislative History Concerning Lost "Opportunity Costs" 18
- C. Adequate Protection and the Fifth Amendment 21
- D. Subsequent Legislative Action 25

IV. The Statutory Scheme of the Bankruptcy Code 29

- A. The Interest Provisions of the Bankruptcy Code 29

TABLE OF CONTENTS—Continued

Pages

B. Other Inconsistent Provisions of the Bankruptcy Code 36

C. Other Protections Against Delay by the Debtor 40

D. Inconsistencies with the Bankruptcy Code and the *Timbers* View 41

V. Conclusion 44

TABLE OF AUTHORITIES

Cases:

Pages

Agins v. City of Tiburon, 447 U.S. 255 (1980) 22

Alyucan Interstate Corp., In re, 12 Bankr. 803 (Bankr. D. Utah 1981) 7

American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry., 233 U.S. 261 (1914) 29

American Mariner Industries, Inc., In re, 734 F.2d 426 (9th Cir. 1984) .... *passim*

Barth Equip. Co. v. Perlstein, 128 F.2d 253 (2d Cir. 1942) 21, 41, 42

Bateman Fin. Corp., In re, 5 C.B.C. 488 (Bankr. M.D. Fla. 1975) 19

Bear Creek Ministorage, Inc., In re, 49 Bankr. 454 (Bankr. S.D. Tex. 1985) 1, 47

Bermec Corp., In re, 445 F.2d 367 (2d Cir. 1971) (per curiam) 9, 21

Bric of America, Inc., In re, 4 C.B.C. 34 (Bankr. M.D. Fla. 1975) 19, 20

Caplan v. Anderson, 256 F.2d 416 (5th Cir. 1958) 18

Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939) 8

Castle Village Co., In re, 13 C.B.C. 452 (Bankr. S.D.N.Y. 1977) 19

City of New York v. Saper, 336 U.S. 328 (1949) 29

Consumer Product Safety Commission v. GTE Sylvania, Inc., 447 U.S. 102 (1980) 27, 28

Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R. I. & P. Ry. Co., 294 U.S. 648 (1935) 24

Empire Steel Co., In re, 228 F. Supp. 316 (D. Utah 1964) 19

Pages

Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976) 6

First English Evangelical Lutheran Church v. County of Los Angeles, California, 107 S. Ct. 2378 (1987) 22

Groundhog Mountain Corp., In re, 4 C.B.C. 387 (Bankr. S.D.N.Y. 1975) 19

Group of Institutional Investors v. Chicago, M., St. P. & P. Ry. Co., 318 U.S. 523 (1943) 29, 30

Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1436 (4th Cir. 1985) 2, 5

Hamilton Mortgage Corp., In re, 13 C.B.C. 77 (Bankr. E.D. Tenn. 1977) 19

Hartsdale Assocs., In re, 11 C.B.C. 87 (Bankr. S.D. N.Y. 1976) 19

I.C.C. v. Railway Labor Executives Ass'n, 315 U.S. 373 (1942) 27

Jenifer Mall Corp., In re, 2 C.B.C. 657 (Bankr. D.D.C. 1974) 19, 20

Lax Enters., In re, 11 C.B.C. 628 (Bankr. N.D. Ohio 1976) 19

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) 22, 23, 24

Manville Forest Prods. Corp., In re, 43 Bankr. 293 (Bankr. S.D.N.Y. 1984) 38

Murel Holding Corp., In re, 75 F.2d 941 (2d Cir. 1935) 9, 10

N.L.R.B. v. Bell Aerospace Co., 416 U.S. 267 (1974) 28

Nevada Towers Assoc., In re, 14 C.B.C. 146 (Bankr. S.D.N.Y. 1977) 19

New Haven Inclusion Cases, 399 U.S. 392 (1970) 24

Newjer Contracting Co., In re, 154 F. Supp. 567 (D.N.J. 1957) 21

Nicholas v. United States, 384 U.S. 678 (1966) 29

Pages

O.K. Motels, In re, 1 C.B.C. 416 (Bankr. M.D. Fla. 1974) 19

Overmyer Co., Inc., In re, 10 C.B.C. 389 (Bankr. S.D.N.Y. 1976) 19

Penn. Mut. Life Ins. Co. v. Lederer, 252 U.S. 523 (1920) 27

Pine Lake Village Apartment Co., In re, 19 Bankr. 819 (Bankr. S.D.N.Y. 1982) 10

Plaza Towers, Inc., In re, 294 F. Supp. 714 (E.D. La. 1967) 19

Reconstruction Fin. Corp. v. Kaplan, 185 F.2d 791 (1st Cir. 1950) 18

Red Lion Broadcasting Co. v. F.C.C., 395 U.S. 367 (1969) 27

Saypol, In re, 31 Bankr. 796 (Bankr. S.D.N.Y. 1983) 11, 17

Scripps-Howard Radio, Inc. v. F.C.C., 316 U.S. 4 (1942) 27

Seatrain Shipbuilding Corp. v. Shell Oil Co., 444 U.S. 572 (1980) 28

Sexton v. Dreyfus, 219 U.S. 339 (1911) 29, 33

Shriver, In re, 33 Bankr. 176 (Bankr. N.D. Ohio. 1983) 7, 10, 16, 35

Sixth Avenue Inv. & Dev. Co., In re, 2 B.C.D. 1222 (Bankr. S.D. Cal. 1976) 19

South Village, Inc., In re, 25 Bankr. 987 (Bankr. D. Utah 1982) 10, 16, 17, 37, 38, 39

Thomas v. Western Car Co., 149 U.S. 95 (1893) 29

Ticonic Nat'l Bank v. Sprague, 303 U.S. 406 (1938) 29

TABLE OF AUTHORITIES—Continued

	Pages
Timbers of Inwood Forest Assocs., Ltd., In re, 793 F.2d 1380 (5th Cir. 1986), *aff'd en banc,* 808 F.2d 363 (5th Cir. 1987)	*passim*
Touche Ross & Co. v. Redington, 442 U.S. 560 (1979)	6, 47
United States v. Price, 361 U.S. 304 (1960)	27
Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946)	1, 29, 30, 31, 32, 36, 44
Wisconsin Cent. Ry. Co., In re, 64 F. Supp. 251 (D. Minn. 1946)	21
Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940)	24, 25
Wright v. Vinton Branch of Mountain Trust Bank, 300 U.S. 440 (1937)	24
Yale Express System, In re, 370 F.2d 433 (2d Cir. 1966), *after remand,* 384 F.2d 990 (2d Cir. 1967)	9, 21
Zuber v. Allen, 396 U.S. 168 (1969)	27

UNITED STATES STATUTES:

Act of June 28, 1934, ch. 869, 48 Stat. 1289, *codified at* 11 U.S.C. § 203(s) (1940)	23
Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of 11 U.S.C. and 28 U.S.C.)	28
Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. — (1986) (H.R. 5316)	25
11 U.S.C. § 361	*passim*
11 U.S.C. § 362	3, 5, 19, 20

TABLE OF AUTHORITIES—Continued

	Pages
11 U.S.C. § 363	39, 40, 46
11 U.S.C. § 364	20
11 U.S.C. § 502	1, 29, 30, 31, 32, 34, 35
11 U.S.C. § 506	*passim*
11 U.S.C. § 552	40
11 U.S.C. § 554	43
11 U.S.C. § 725	43
11 U.S.C. § 726	43
11 U.S.C. § 1111	38, 39, 45, 46
11 U.S.C. § 1124	36, 37, 38
11 U.S.C. § 1129	8, 13, 37, 38
11 U.S.C. § 1205	26

TEXTS:

Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain,* 91 Yale L.J. 857 (1982)	16, 37
O'Toole, *Adequate Protection and Post-Petition Interest in Chapter 11 Proceedings,* 56 Am. Bankr. L.J. 251 (1982)	34
Report to the Commission on the Bankruptcy Laws of the United States, H. R. Doc. No. 137, 93d Cong., 1st Sess. pt. II at 237 (1973)	14

OTHER AUTHORITIES:

Bankr. R. 3014	39
124 Cong. Rec. H11092 (daily ed. Sept. 28, 1978)	15

TABLE OF AUTHORITIES—Continued

Pages

124 Cong. Rec. S17408-09 (daily ed. Oct. 6, 1978) 15

H.R. Rep. No. 595, 95th Cong., 1st Sess. (1978) *reprinted in* 1978 U.S. Code, Cong. & Ad. News 5963 .... 7, 12, 15, 16

S. Rep. No. 989, 95th Cong., 2d Sess. (1978) *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787 .... 9, 14, 15, 16, 18

STATEMENT OF THE CASE

To the Statement of the Case submitted by Petitioner, Respondent would add the following: Petitioner states that "[b]ecause the Court also found that the market value of the property was less than the debt secured thereby, 49 B.R. at 460, App. F at 155a, there was nothing to secure the payment of rapidly-accruing interest under the note." Brief for Petitioner at 4. This statement ignores a fundamental principle of bankruptcy law, that an unsecured creditor (or in this case an undersecured creditor) is not allowed, as part of its claim, an accrual of interest during the postpetition period. *See Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946); 11 U.S.C. §§ 502(b)(2), 506(b) (1982).

Respondent would also add the fact that since the filing of the reorganization case on March 4, 1985, Respondent has continued to make payments to Petitioner, as directed by the Bankruptcy Court, *In re Bear Creek Ministorage, Inc.*, 49 Bankr. 454, 460 (Bankr. S.D. Tex. 1985), consisting of all excess cash flow (net operating income) over and above ordinary and necessary operating expenses generated by the apartment complex commonly known as Timbers of Inwood Forest Apartments, Phase I (the "Property"), securing the debt of Petitioner. Such payments equal, and very likely could exceed, the amount that Petitioner would receive if it were in possession of the Property.

SUMMARY OF ARGUMENT

Adequate protection called for in sections 361 and 362 of the Bankruptcy Reform Act of 1978[1] can be provided by any means which insures that a secured creditor will receive at confirmation at least the value of its collateral as of the date the petition is filed initiating a bankruptcy case. *See In re Timbers of Inwood Forest Associates, Ltd.*, 793 F.2d 1380 (5th Cir. 1986) [hereinafter "*Timbers I*"], *aff'd en banc*, 808 F.2d 363 (5th Cir. 1987) [hereinafter "*Timber II*"]. The United States Courts of Appeals for the Ninth and Fourth Circuits, in construing the same statute, have concluded that adequate protection requires, in addition to protection of the value of the secured creditor's collateral, protection for other "interests" that arise from the contractual relationship between the creditor and debtor. *Grundy National Bank v. Tandem Mining Corp.*, 754 F.2d 1436 (4th Cir. 1985); *In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984) [hereinafter "*American Mariner*"].

This Court should look to (1) the language of the statute, (2) the legislative history to ascertain more clearly the intent of Congress, and (3) the harmony between the interpretation of the particular statute and the entire statutory scheme involved in order to construe the statute involved herein. The language of this particular statute is somewhat ambiguous, although convincing arguments can be made to support the *Timbers* view.

---

[1] The Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101-1331 (1982 & West Supp. 1987) will be hereinafter referred to as the "Bankruptcy Code," and all reference to "section" followed by a number shall be to the enumerated sections of the Bankruptcy Code as amended, unless otherwise specified.

Numerous explicit statements in the legislative history approve the Fifth Circuit's interpretation of the statute. The Ninth Circuit has only cited generalized references in the legislative history which are subject to more than one interpretation.

Harmonization of sections 361 and 362 with the entire structure of the Bankruptcy Code compels support of the Fifth Circuit's interpretation. When the entire Bankruptcy Code is considered in conjunction with the Ninth Circuit's interpretation of sections 361 and 362, many glaring and irreconcilable inconsistencies appear, embracing both portions of the statute codifying long standing concepts of judicial creation and concepts which were created by the 1978 Congress. Superimposition of the Ninth Circuit's interpretation upon the now-existing Bankruptcy Code creates a situation whereby the filing of a bankruptcy petition bestows greater rights upon undersecured creditors than they would enjoy under their contract and under state law.

Petitioner requests the Court to interpret a federal statute in such a way as to result in extremely favorable treatment for one very specialized class of interests of which it is a member. The established prinicples of statutory construction overwhelmingly indicate that the *Timbers* view is the correct interpretation of the statutes in question. The proper forum for Petitioner's request is Congress, where other competing interests can be considered.

ARGUMENT

I. INTRODUCTION

Since the passage of the Bankruptcy Code there has been a split of authorities on the issue presented in this appeal. One line of authority has held that adequate protection for an undersecured creditor, such as Petitioner in this case, can be provided by any means which insures that the creditor will ultimately receive the value of the collateral securing its lien as of the date of filing of the petition initiating a bankruptcy case. To the extent that the value of the collateral might decrease, the debtor will be required to compensate the undersecured creditor for the decrease in the value of the collateral. *See Timbers I*, 793 F.2d at 1416.

A contrary line of authority has adopted the view that an undersecured creditor is entitled not only to adequate protection for the decrease in value of its collateral, but also to protection for other "interests" that arise from the contractual relationship between the creditor and debtor, in particular, the creditor's right to realize the value of its collateral upon a theoretical foreclosure, reinvest the proceeds of sale, and earn interest on the reinvested amount. Such theoretical earned interest is commonly referred to as the creditor's lost "opportunity costs". In order to protect such an interest, the debtor is required to compensate the creditor by paying interest at current market rates on the liquidation value of the collateral. Such payments have been equated with the "time value" of the

creditor's foreclosure rights. *See Grundy National Bank*, 754 F.2d at 1441; *American Mariner*, 734 F.2d at 430-31.[2]

The focus of these contrary lines of authority revolves around the interpretation of the Bankruptcy Code, specifically sections 361[3] and 362(d)[4], and the definition of the term "adequate protection" used in the sections. An analysis should begin with the applicable principles of statutory construction.

This Court has had many occasions in which to interpret federal statutes. Statutory construction involves three areas of inquiry: (i) the language of the statute, (ii) the legislative history to ascertain more clearly the intent of Congress, and (iii) the harmony between the interpretation of the particular statute and the entire statutory scheme involved. *See Touche, Ross & Co. v. Redington*, 442 U.S. 560, 568 (1979); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 200-01 (1976).

---

[2] For a compilation of the lower courts' opinions, see *Timbers I*, 793 F.2d at 1411-13.

[3] Section 361. *Adequate Protection.* When adequate protection is required under section 362, 363 or 364 of this title of an interest of an entity in property, such adequate protection may be provided by—(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that the stay under section 362 of this title, use, sale, or lease under section 363 of this title, or any grant of a lien under section 364 of this title results in a decrease in the value of such entity's interest in such property; (2) providing to such entity an additional or replacement lien to the extent that such stay, use, sale, lease, or grant results in a decrease in the value of such entity's interest in such property; or (3) granting such other relief, other than entitling such entity to compensation allowable under Section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property.

[4] Section 362(d). On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; or (2) with respect to a stay of an act against property under subsection (a) of this section, if—(A) the debtor does not have an equity in such property; and (B) such property is not necessary to an effective reorganization.

Upon consideration of the analysis of the issue presented on appeal in light of these three principles of statutory construction, the only logical answer is that the *Timbers* view states what the law is; the *American Mariner* view represents an unmistakable attempt at judicial legislation which must not be condoned by this Court.

II. THE LANGUAGE OF SECTION 361

A. The "Interest" to be Protected

The Petitioner and its amici make much of the fact that section 361 speaks of the "interest" of a creditor which is to be protected. They argue that the interest of an undersecured creditor includes not only its secured claim but also the value of its lost "opportunity costs."[5]

Reference to the legislative history shows that there is a simple reason why Congress used the word "interest" in section 361 instead of the word "claim." The House Report states:

---

[5] Curiously, the Petitioner makes the argument that the undersecured creditor's claim under section 506(a) *includes* its lost "opportunity costs." Brief for Petitioner at 43. If this construction is correct, then Petitioner is arguing against itself by stating that its claim and its interest are different.

> The interests of which the court may provide protection in the ways described in [section 361] include equitable as well as legal interests. For example, a right to redeem under a pledge or a right to recover property under a consignment are both interests that are entitled to protection.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 338 (1978) *reprinted in* 1978 U.S. Code, Cong. & Ad. News 5963, 6294 [hereinafter cited as "House Report" without parallel citation].

Clearly Congress intended that entities other than secured creditors be provided with adequate protection for their interests. For example, a co-owner, a lessor or a consignor would have an ownership interest in property for which the debtor would have to provide adequate protection. The word "interest" refers to interests which may be held by entities other than secured creditors and not to other interests which may be held by secured creditors.

A secured creditor's interest is defined in section 506(a) which uses the word "interest" in defining the extent of a creditor's secured claim. According to section 506(a), the creditor's interest includes only the "estate's interest" in property on which the creditor has a lien. *See* Section 506(a). The estate's interest could not possibly extend to the lost "opportunity costs" of the creditor. In the case of an undersecured creditor, section 506(a) provides that a secured claimant's "interest" equals only the value of the collateral. *See In re Shriver*, 33 Bankr. 176, 181 (Bankr. N.D. Ohio 1983); *In re Alyucan Interstate Corp.*, 12 Bankr. 803, 808 (Bankr. D. Utah 1981). It is this interest, the creditor's secured interest, which deserves adequate protection, and, as defined in section 506(a), includes only the value of the claimant's collateral.

B. "Adequate Protection" and the "Indubitable Equivalent"

The Petitioner makes the argument that the words "adequate protection" and "indubitable equivalent" had certain well understood meanings under the Bankruptcy Act of 1898, as amended [hereinafter the "Bankruptcy Act"] and that these same meanings should apply when the words are used in the Bankruptcy Code. It cites for the proposition the Supreme Court case of *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939) in which the Court states, "where words are employed in an act which had at the time a well known meaning in the law, they are used in that sense unless the context requires the contrary." *Case,* 308 U.S. at 115 (citations omitted).

The obvious response to the Petitioner's argument is that, in fact, the words are used in the Bankruptcy Code in a different context. The words under the Bankruptcy Act were used in the context of a confirmation of a plan of reorganization where the rights of all involved were permanently fixed. The confirmation of a plan takes place after disclosure, solicitation of acceptance from all impaired creditors and a full-blown confirmation hearing noticed to all. *See* Section 1129. In contrast, adequate protection as called for under the Bankruptcy Code denotes interim relief necessary to protect a creditor during the period from the filing of a petition initiating the bankruptcy case until the confirmation hearing. The granting of adequate protection usually comes early in the case, in an expedited manner and after only limited notice to the entities directly involved. It is a completely different concept and its meaning under the Bankruptcy Act as a confirmation standard is not particularly helpful in determining the scope of adequate protection under the Bankruptcy Code as an interim protection standard.

The term "indubitable equivalent" is derived from Justice Learned Hand's opinion in *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935). In *Murel,* the court was facing a plan of reorganization which had been rejected by a creditor who was to receive under the plan interest payments for ten years, with no amortization of the principal of the debt. The *Murel* court held that the plan could not be confirmed over the creditor's objection, because the plan's success was too uncertain and speculative to afford the creditor adequate protection.[6] The *American Mariner* view concludes that Congress' use of the indubitable equivalent language in section 361 meant Congress intended to expand the concept embraced by the *Murel* case beyond application to a plan confirmation. *American Mariner,* 734 F.2d at 434.

The most obvious distinction between *Murel* and the case *sub judice* is that in *Murel,* Justice Hand was dealing with a situation where a plan of reorganization had been proposed and the creditor's rights were to be fixed as a matter of finality for a ten-year period. *See Murel,* 75 F.2d at 942. Adequate protection under section 361, on the other hand, was intended by Congress as short term, interim protection. *See Shriver,* 33 Bankr. at 183-84; *In re South Village, Inc.,* 25 Bankr. 987, 991 n.4 (Bankr. D. Utah 1982); *In re Pine Lake Village Apartment Co.,* 19 Bankr. 819, 823-24 (Bankr. S.D.N.Y. 1982). *Murel* addressed an extreme factual situation and, thus, to a large extent, is a fact-specific holding. *See South Village,* 25 Bankr. at 991-92 n.4. Since the debtor in *Murel* had already proposed interest payments, the actual holding is that provision must be made for safety of the collateral and repayment of the *principal* in a plan of reorganization. *See Murel,* 75 F.2d at 942-43. The contention that the *Murel* case requires adequate protection in the context of interim protection to be the same as that required in the context of a plan of reorganization is inconsistent with the case itself. As Justice Learned Hand concluded, "[n]o doubt less will be required to hold up the suit for a short time until the debtor shall have a chance to prepare; much depends on how long he had already, and upon how much more he demands." *Murel* 75 F.2d at 943. Thus, since adequate protection under the Bankruptcy Code addresses the "short time" that the debtor is to be given to prepare, even the *Murel* language supports the *Timbers* view. *See Timbers I,* 793 F.2d at 1389.

---

[6] The *Murel* holding has been interpreted to mean that when a plan is confirmed, a creditor must be provided with at least the present value of its allowed claim. *See American Mariner,* 734 F.2d at 433. *Murel* was cited with approval in the legislative history under section 1129, but no mention of it is made in the statements regarding section 361. Later Second Circuit cases discussing different interim protection standards are cited favorably in the history of section 361. *See* House Report at 339 (citing *In re Yale Express System,* 384 F.2d 990 (2d Cir. 1967)); S. Rep. No. 989, 95th Cong., 2d Sess. 54, *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5839-40 (citing *In re Bermec Corp.,* 445 F.2d 367 (2d Cir. 1971)) [hereinafter cited as "Senate Report" without parallel citation]. Thus, the legislative history supports the conclusion that *Murel* applies only in the context of the confirmation of a plan of reorganization and *Yale Express* and *Bermec* apply to section 361.

One bankruptcy court offered this analysis of the meaning of the term "indubitable equivalent" in section 361:

> Here, however, a phrase has been transplanted from one context to another. Stretching out payment to a secured creditor over ten years pursuant to a plan in preference to junior interests entails far greater uncertainty than staying a secured creditor from realization of his value in the collateral during the pendency of the proceeding.

In re Saypol, 31 Bankr. 796, 802 (Bankr. S.D.N.Y. 1983).

The House version of section 361 was much broader than the Senate as originally proposed. The Senate version contained only what is now sections 361(1) and 361(2). It was the House version which had the equivalent of section 361(3), except that instead of the words "indubitable equivalent," the House had used the term "value." During the final negotiations the phrase "indubitable equivalent" was substituted for "value" as a compromise to limit the scope of the House version. The *Saypol* court noted, while analyzing the substitution, "[i]t seems closer to the mark to reason that the terms were substantively interchangeable and 'indubitable equivalent' added only to confirm that the court should address, in an appropriate case, the uncertainty stated by Judge Hand rather than the cost of a lost opportunity to invest." *Saypol,* 31 Bankr. at 802. In other words, as a compromise, the final version of section 361 was to be a more restrictive approach to the determination of the forms of adequate protection than the original House version. In view of this history, it is ironic that the *American Mariner* court interpreted this language to stand for the extremely expansive concept of providing adequate protection for contractual rights. *See Timbers I,* 793 F.2d at 1398-1401.

The conclusion of the *Saypol* court is that the term does mean the same in both contexts. "Indubitable equivalent" refers to the quality of the protection provided, the "certainty," but does not address the question of whether the scope extends to the "time value" of the interest protected. *See Timbers I*, 793 F.2d at 1389.

C. The "Value" of the Interest

Professor Jackson in his amicus brief makes the argument that the only real value of a security interest to a creditor lies in the timing of its foreclosure. Therefore, when Congress used the word "value" in section 361, it was referring to this value for which the secured creditor needed protection. *See* Brief of Thomas H. Jackson, *Amicus Curiae*, at 4-6. However, the legislative history makes it clear that the use of the word "value" in section 361 does not include a concept of *what* is to be valued, only how and when the valuation should occur. The House Report states:

> The section does not specify how value is to be determined, nor does it specify when it is to be determined. These matters are left to case-by-case interpretation and development. . . .
>
> Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes.

House Report at 339.

It is clear from a simple reading of this legislative history that the word "value" refers to the value of physical property since it speaks in terms of liquidation or going concern value. The lost "opportunity costs" of a secured creditor would be valued according to the current market for the use of money. It makes no sense to speak of lost "opportunity costs" as having "liquidation" or "going concern" value. The word "value" as used in section 361 does not extend to "time value" as exemplified by lost "opportunity costs."

D. Comparison with the Language Used in Section 1129

Petitioner states that Congress meant for time value to be included in both sections 361 and 1129 because the language in both sections is so similar. However, crucial differences in the language mandate differences in the approaches of the sections. Section 1129 states that the value of the deferred cash payments required under the plan must have a certain value as of the effective date of the plan. It is these words, "as of the effective date of the plan," that denote present value. *See Timbers I*, 793 F.2d at 1402 n.41. This language, completely lacking in section 361, is the language mandating protection of the time value of the creditor's claim. There is no reason why Congress could not have similarly made section 361 clear by the inclusion of the same language. *See Timbers I*, 793 F.2d at 1402.[7]

III. LEGISLATIVE HISTORY

A. Adequate Protection in the Legislative History

Numerous examples exist in the legislative history explaining the scope of adequate protection. The Commission proposal describes adequate protection as protecting a creditor "to the extent of the anticipated decrease in the value of the collateral as a result of use." Report to the Commission on the Bankruptcy Laws of the United States, H. R. Doc. No. 137, 93d Cong., 1st Sess. pt. II at 237 (1973). The Commission proposal was subsequently codified as section 361 of the Bankruptcy Code.

---

[7] It is also interesting to note that section 1129 uses the same language to denote the creditor's interest as that found in section 506(a). The creditor's interest extends only so far as the estate's interest in the property. Here again, it is clear that the creditor's interest includes only its claim.

The House Report states in its discussion of section 361(1) that "[t]he use of periodic payments may be appropriate, where, for example, the property in question is depreciating at a relatively fixed rate. The periodic payments would be to compensate for the depreciation." House Report at 339. In discussing section 361(2), the House Report states that "[t]he second method is the provision of an additional or replacement lien on other property to the extent of the decrease in value of the property involved. The purpose of this method is to provide the protected entity with a means of realizing the value of the original property, if it should decline during the case, by granting an interest in additional property from whose value the entity may realize its loss." House Report at 339-40.

Similarly, in the Senate Report, the concept of adequate protection is described at the outset of the Report as requiring "either cash payments or a replacement lien [to] be provided the creditor whose collateral is decreasing in value or is being consumed during the stay." S. Rep. No. 989, 95th Cong., 2d Sess. 4 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 5787, 5790 [hereinafter cited as "Senate Report" without parallel citation]. In its discussion of section 361(1), the Senate Report mirrors

the House Report.[8] In discussing section 361(2), the Senate Report uses the same language as the House Report, and further states that such language "is consistent with the view expressed in *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940), where the Court suggested that it was the value of the secured creditor's collateral, and not necessarily his rights in specific collateral, that was entitled to protection." Senate Report at 54. After the Senate and House bills had been redrafted and the final version of section 361 emerged, the floor leaders commented that

> [a]dequate protection of an interest of an entity in property is intended to protect a creditor's allowed secured claim . . . In the special case of a creditor . . . making an election under section 1111(b)(2), that creditor is entitled to adequate protection of the creditor's interest in property to the extent of the value of the collateral not to the extent of the creditor's allowed secured claim, which is inflated to cover a deficiency as a result of such election.

124 Cong. Rec. H11092 (daily ed. Sept. 28, 1978); 124 Cong. Rec. S17408-09 (daily ed. Oct. 6, 1978). Pursuant to section 506(a), the allowed secured claim of an undersecured creditor is the value of its collateral. These numerous explicit references in the Congressional Record are convincing proof of the intent of Congress to limit the "interest" of an undersecured creditor entitled to adequate protection to the value of the collateral securing its

---

[8] "The use of periodic payments may be appropriate where, for example, the property in question is depreciating at a relatively fixed rate. The periodic payment would be to compensate for the depreciation and might, but need not necessarily, be in the same amount as payments due on the secured obligation." Senate Report at 54.

claim. *See Timbers I*, 793 F.2d 1393-1401; *Shriver*, 33 Bankr. at 184-86; *South Village*, 25 Bankr. at 996.

There is additional support for the *Timbers* view in the legislative record based on the cases under the Bankruptcy Act cited with approval in the legislative record. Senate Report at 53-54; House Report at 338-40. As Professor Jackson explains in his article:

> The Court in *In re Yale Express System*, 384 F.2d 990 (2d Cir. 1967), refused to allow Fruehauf Corporation, a secured creditor, either to take possession of its collateral (trailers and truck bodies) or to collect rental payments during the reorganization of Yale Express System despite the fact that the collateral was depreciating. Instead, Fruehauf was deemed protected since "the trustee has offered to fix the value of the security interest claimed by Fruehauf so that its position in any reorganization will be unaffected by possible depreciation." 384 F.2d at 992. This case was cited approvingly by H. R. Rep. No. 595, *supra*, note 11 at 338-340. . . . Nor was Fruehauf to be compensated for the interest that was accruing because of the delay itself. The court in *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971), cited approvingly by S. Rep. No. 989, *supra*, note 76, at 53-54, granted Pacar Financial Corporation, a secured creditor, payments equal "to the actual current depreciation of the value of the rolling stock" in lieu of a right to repossess or a right to collect rentals during Bermec's reorganization. *In re Bermec Corp.*, No. 71-B-291 (Bankr. S.D.N.Y.) *aff'd* 445 F.2d 367 (2d Cir. 1971).

Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857, 875 n.81 (1982). Professor Jackson recognizes that the cases cited by the Senate and House approvingly do not provide for compensation for lost "opportunity cost" as part of adequate protection. The *American Mariner* court is in error when it asserts that "the early cases, decided before enactment of the Bankruptcy Reform Act of 1978, are of little relevance in construing sections 361 and 362." *American Mariner*, 734 F.2d at 434. When a case is cited in the legislative history, Congress considers the case to be relevant to a proper construction of the statute.

Neither *American Mariner* nor the Petitioner point to any explicit statements or case citations in the legislative history to support a conclusion that Congress intended that an undersecured creditor receive, as adequate protection, compensation for its lost "opportunity costs." There existed pre-Bankruptcy Code authority supporting the *American Mariner* view. *See Saypol*, 31 Bankr. at 801 n.6, 802; *South Village*, 25 Bankr. at 994 n.8. Yet the cases cited by Congress in the Reports support the ***Timbers*** view.

American Mariner and the Petitioner rely on general language included in both the House and Senate Reports' introduction to section 361. The Reports recognize that a creditor should not be deprived of the "benefit of its bargain," and that a secured creditor should receive in value "essentially what he bargained for." Such general language is, however, ambiguous on its face. Consider the language of the Senate:

> Secured creditors should not be deprived of the benefit of their bargain. There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the policy of the bankruptcy laws. Thus, this section [section 361] recognizes the availability of alternate means of protecting a secured

> creditor's interest where such steps are a necessary part of the rehabilitative process. Though the creditor might not be able to retain his lien upon the specific collateral held at the time of filing, the purpose of the section is to insure that the secured creditor receives the value for which he bargained.

Senate Report at 53. This quote, interpreted in conjunction with the remarks of the Senate Report quoted *supra* at p. 15, distinctly indicates that the "benefit of a secured creditor's bargain" means a secured creditor is entitled to protection of the *value* of the collateral and not necessarily its rights in specific collateral. The legislative history supports denial of protection to the right of a secured creditor to take possession of and sell the collateral, and does not suport such protection as *American Mariner* contends.

B. The Silence of the Legislative History Concerning Lost "Opportunity Costs"

Petitioner states discussion of lost "opportunity costs" in the context of adequate protection was not necessary in the legislative history since pre-Code cases had always protected the lost "opportunity costs" of a secured creditor by allowing termination of the stay rather than conditioning its continuance on any sort of protection. However, the cases Petitioner cites do not bear this theory out. Rather, the cases cited by the Petitioner stand for the proposition that when there is no reasonable hope of reorganization within a reasonable period of time, the continuation of the automatic stay is not justified.[9] This

creditor protection has indeed been carried forward in the Bankruptcy Code but under section 362(d)(2), and ot under the concept of adequate protection set forth in ection 362(d)(1). *See Timbers II*, 808 F.2d at 370-71.[10]

The holdings of the vast majority of the cases cited by the Petitioner are based on the standard set forth in section 362(d)(2). The courts considered evidence on whether the debtor had shown some justification for the continuation of the stay in the form of some progress toward reorganization and some evidence that a reorganization was possible within a reasonable amount of time independent of some contingent event out of the control of the debtor. The most relevant consideration was whether the debtor could be reorganized. *Compare Timbers II*, 808 F.2d at 371 (debtor must show reasonable prospect of reorganization within reasonable time) *with In re Groundhog Mountain Corp.*, 4 C.B.C. 387, 394 (Bankr. S.D.N.Y. 1975) (under Bankruptcy Act, mere hope of reorganization

---

[9] *See Caplan v. Anderson*, 256 F.2d 416, 418 (5th Cir. 1958); *Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791 (1st Cir.

(Continued on following page)

(Continued from previous page)

1950); *In re Plaza Towers, Inc.*, 294 F. Supp. 714, 720 (E.D. La. 1967); *In re Empire Steel Co.*, 228 F. Supp. 316, 319 (D. Utah 1964); *In re Nevada Towers Assoc.*, 14 C.B.C. 146, 151 (Bankr. S.D.N.Y. 1977); *In re Castle Village Co.*, 13 C.B.C. 452, 465 (Bankr. S.D.N.Y. 1977); *In re Hamilton Mortgage Corp.*, 13 C.B.C. 77, 99 (Bankr. E.D. Tenn. 1977); *In re Hartsdale Assocs.*, 11 C.B.C. 87, 93 (Bankr. S.D.N.Y. 1976); *In re Sixth Avenue Inv. & Dev. Co.*, 2 B.C.D. 1222, 1228 (Bankr. S.D. Cal. 1976); *In re Lax Enters.*, 11 C.B.C. 628, 632 (Bankr. N.D. Ohio 1976); *In re Overmyer Co., Inc.*, 10 C.B.C. 389, 398 (Bankr. S.D.N.Y. 1976); *In re Bateman Fin. Corp.*, 5 C.B.C. 488, 492 (Bankr. M.D. Fla. 1975); *In Re Groundhog Mountain Corp.*, 4 C.B.C. 387, 394 (Bankr. S.D.N.Y. 1975); *In re Bric of America, Inc.*, 4 C.B.C. 34, 40 (Bankr. M.D. Fla. 1975); *In re Jenifer Mall Corp.*, 2 C.B.C. 657, 663 (Bankr. D.D.C. 1974); *In re O.K. Motels*, 1 C.B.C. 416, 420 (Bankr. M.D. Fla. 1974).

[10] The Petitioner did not seek relief under section 362(d)(2) in its original motion. Joint Appendix, app. 4.

"too slim a reed" upon which to maintain stay). Thus, in the *Jenifer Mall* case, the stay was lifted even though the creditor was oversecured because the court found that no plan could be proposed within a reasonable amount of time. *See Jenifer Mall*, 2 C.B.C. 657, 663-64 (Bankr. D.D.C. 1974). The same result was maintained in the case of an undersecured creditor where the court found that the property was not necessary to the reorganization of the debtor. *See In re Bric of America, Inc.*, 4 C.B.C. 34, 37, 39-40 (Bankr. M.D. Fla. 1975).

While the aforementioned cases discuss the accrual of interest a secured creditor may or may not ultimately receive, this factor, seen as a harm to the creditor, is what is balanced against the need of the debtor to reorganize, weighed by the possibility of such reorganization. The protection afforded secured creditors by this analysis is found in section 362(d)(2) of the Bankruptcy Code and not in any concept of adequate protection.[11] *See Timbers I*, 793 F.2d at 1389-93.

The adequate protection concept found in section 362 (d)(1) is based on the cases cited with approval in the legislative history. While these cases may not detail the form of adequate protection required, since the legislative history reserves judgment on that aspect, they are instructive in discerning the scope of adequate protection under the Bankruptcy Code.

---

[11] Petitioner is being inconsistent in its statements that, as to these cases, the concern of the court with the accruing interest of the secured creditor shows a concern for lost "opportunity costs" when, later in its brief, the Petitioner insists that interest accruing on the debt and lost "opportunity costs" are not comparable.

In *Yale Express* the concept of lost "opportunity costs" was directly addressed in the form of the creditor's request for "rent" for property on which it claimed a right of reclamation. A motion to exercise a right of reclamation was very similar to a motion for relief from stay except that under a conditional sales contract before the acceptance by the States of the Uniform Commercial Code, a creditor retained title to the property. The creditor in *Yale Express* asked for two forms of relief, return of its property or, in the alternative, rent to compensate for loss of income engendered by the delay. *In re Yale Express System*, 370 F.2d 433, 435 (2d Cir. 1966). The Second Circuit denied the creditor's right to either, stating that allowing lost "opportunity costs" to this creditor would require allowing them to all creditors holding security which would nullify the reorganization. *In re Yale Express System*, 384 F.2d 990, 992 (2d Cir. 1967). Thus, the court limited the scope of protection required to protection for a decrease in the value of the collateral securing the creditor's claim.[12] The *Bermec* court reached the same conclusion as to the scope of adequate protection. *See In re Bermec Corp.*, 445 F.2d 367, 369 (2d Cir. 1971) (per curiam).

C. Adequate Protection and the Fifth Amendment

The Petitioner and its amici make two arguments which attempt to link lost "opportunity costs" with the Fifth Amendment concept of taking without just compensation. Petitioner asserts that, since this Court has recently allowed compensation for a temporary taking under the Fifth Amendment, undersecured creditors should be allowed compensation for the delay in the enforcement of their rights. *See First English Evangelical Lutheran Church v. County of Los Angeles, California,* 107 S. Ct. 2378 (1987). This argument carries little weight unless the Petitioner concedes that the operation of section 362 of the Bankruptcy Code has violated its Fifth Amendment rights in temporarily taking its property without compensation. Since no such concession has been made, the *First English* case is easily distinguishable from the Petitioner's situation. Even in the context of a Fifth Amendment taking, uncompensated delay is a recognized component. *See Agins v. City of Tiburon,* 447 U.S. 255, 263 n.9 (1980).

---

[12] For other reclamation cases with similar holdings, see *Barth Equip. Co. v. Perlstein*, 128 F.2d 253, 254 (2d Cir. 1942); *In re Newjer Contracting Co.*, 154 F. Supp. 567, 569 (D.N.J. 1957); and *In re Wisconsin Cent. Ry. Co.*, 64 F. Supp. 251, 259 (D. Minn. 1946).

In their Brief filed in support of the Petitioner, the California League of Savings Institutions, the American Bankers' Association, and the California Bankers' Association [the "Amici"] further argue that citation of *Louisville Joint Stock Land Bank v. Radford,* 295 U.S. 555 (1935) in the legislative history evinces Congressional intent that the present value analysis contained therein applies to the granting of adequate protection under section 361 of the Code, thus requiring lost "opportunity costs."[13]

The provisions of the Frazier-Lemke Amendment bear little resemblance to the interim protection afforded by the automatic stay. The Frazier-Lemke Amendment was in fact an alternate composition which mortgagees were forced to accept and which effected a permanent disposition of their rights. See Act of June 28, 1934, ch. 869, 48 Stat. 1289, *codified at* 11 U.S.C. § 203(s) (1940). The *Radford* Court was basing its analysis on standards which are appropriate in the context of a confirmation of a plan in modern bankruptcy procedure. This argument of the Amici represents a new twist to an old theme, that interim protection should be commensurate with protection granted under a plan of reorganization. The Court in the *Radford* case does set out a measure for interim protection where it speaks of the power of the court to temporarily enjoin the sale of pledged securities:

> The injunction here in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action. It may be, as suggested, that during the period of restraint the collateral will decline in value; but the same may be said in respect of an injunction against the sale of real estate upon foreclosure of a mortgage; and such an injunction may issue in an ordinary proceeding in bankruptcy. *Straton v. New,* 283 U.S. 318, 321, 51 S. Ct. 465, 75 L.Ed. 1060, and cases cited.

---

[13] The *Radford* case was the landmark Supreme Court case which struck down the first Frazier-Lemke Amendment to the Bankruptcy Act as violating the Fifth Amendment rights of creditors. *See Radford,* 295 U.S. at 601-02. The Amendment provided that a farmer who could not obtain the requisite consents to a composition had an alternate remedy of retaining posses-

(Continued on following page)

(Continued from previous page)

sion of the property for five years and paying its appraised value to the mortgagee at the end of the five years. The farmer was required to pay rent for the property during the five years which was to be distributed to secured and unsecured creditors, apparently in the court's discretion. At the end of the five years, the mortgagee could cause a reappraisal of the real estate and force the debtor to pay the reappraised value into the court. *See* 11 U.S.C. § 203(s)(7) (1940).

Radford, 295 U.S. at 583 (quoting *Continental Illinois National Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.,* 294 U.S. 648, 676-77 (1935)). As to the standard for a temporary delay, *Radford* stands for the proposition that even the value of the collateral need not be protected against a decline during the interim period.[14]

This Court explained the narrow scope of *Radford* in a subsequent case upholding a revision of the Frazier-Lemke Amendment:

> The [*Radford*] opinion enumerates five important substantive rights in specific property which had been taken. It was not held that the deprivation of any one of these rights would have rendered the Act invalid, but that the effect of the statute in its entirety was to deprive the mortgagee of his property without due process of law.

Wright v. Vinton Branch of Mountain Trust Bank, 300 U.S. 440, 457 (1937). *Radford* was a fact-specific holding in which all five substantive rights were abridged. Judgment was reserved as to whether any other combination of impairment of rights would violate the Fifth Amendment. *See Radford,* 295 U.S. at 601. Given this explanation from the Court, it is inappropriate to pick and choose "policies and principles" from *Radford* to transport into an analysis of section 361 of the Bankruptcy Code.

The second case cited with approval by the legislative history is more instructive. *Wright v. Union Central Life*

---

[14] As late as 1970, this Court had held that protection for the value of the collateral in the interim period is not necessarily required under the Fifth Amendment. *New Haven Inclusion Cases,* 399 U.S. 392, 491 (1970). The Bankruptcy Code makes clear that this protection is now mandated by statute. *See* 11 U.S.C. § 361 (1982).

Insurance Co., 311 U.S. 273 (1940). In *Union Central* the Court recognized that the new version of the Frazier-Lemke Amendment preserved the right of a mortgagee to realize upon its security by a judicial sale. The court went on to explain that the right to foreclose can be impaired in bankruptcy:

> By our construction, the exercise of this right is merely deferred or postponed until the other conditions and requirements of the Act, prescribed for the protection of the debtor, have been met. It is eventually denied the creditor only in case he is paid the full amount of what he can constitutionally claim.

Union Central, 311 U.S. at 279. According to the case, what a creditor can constitutionally claim is the value of its collateral. The cite in the legislative history to the *Union Central* case makes clear that the Bankruptcy Code should operate as the Bankruptcy Act had since at least 1940. The right to foreclose can be suspended for a temporary period and then denied altogether if the creditor is given its collateral or its equivalent in value. The Senate Report recognizes this harmony. *See* Senate Report at 53. Thus both the *Union Central* case and the Senate approval of the approach dictate that the *Timbers* view is what Congress intended in section 361 of the Bankruptcy Code. *See Timbers I,* 793 F.2d at 1398.

D. Subsequent Legislative Action

In 1986, Congress enacted an amendment to the Bankruptcy Code entitled the "Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986," Pub. L. No. 99-554, 100 Stat. — (1986) (H.R. 5316) [hereinafter referred to as the "Family Farmer Bankruptcy Act"]. The Petitioner and its amici make two arguments concerning this subsequent legislative action. First, they argue that since, in direct response to the *American Mariner* view, Congress used different language in the adequate protection provisions of the Family Farmer Bankruptcy Act (11 U.S.C. § 1205 (West Supp. 1987)) than that found in section 361, the earlier Congress which enacted section 361 could have also used this language but chose not to. Second, they argue that since Congress considered the *American Mariner* view in the context of section 1205 but did not in the context of section 361, Congress must have meant to endorse the *American Mariner* view as to non-farmer debtors.

To state the first objection is to refute it. Congress in 1978 could not have known what ambiguities the Ninth Circuit Court of Appeals would create in 1984 about the language Congress chose. The subsequent Congress was simply responding to the concerns raised by the *American Mariner* view. This response is not necessarily a comment on deficiencies in the language in section 361. For instance, while in section 361 the 1978 Congress combined all entities' interests into one category, the 1986 Congress set out each entity's interest to clarify that the interest of the secured creditor extends to the value of property securing its claim. What this action of Congress shows is that Congress is capable of responding to judicial misinterpretation of its statutes after such misconstruction, but not before.

As to the argument concerning the failure of Congress to amend section 361, there is ample case law authority from the Supreme Court to conclude that no significance can be attached to such legislative silence.[15] This Court has consistently held that subsequent legislative silence does not give consent. *See Scripps-Howard Radio, Inc. v. F.C.C.*, 316 U.S. 4, 11 (1942).

This Court has also made it clear that comments in subsequent legislative histories are of dubious value in interpreting prior statutes. *See Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 117-18 (1980); *Penn. Mutual Life Insurance Co. v. Lederer*, 252 U.S. 523, 537-38 (1920). In the *GTE Sylvania* case, this Court distinguished the case cited by The National Commercial Finance Association ("NCFA") in its amicus brief:

> Petitioners invoke the maxim that states: "subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction." *Red Lion Broadcasting Co. v. F.C.C.*, 395 U.S. 367, 380-381, 89 S. Ct. 1794, 1801, 23 L.Ed.2d 371 (1969) (footnote omitted). With respect to subsequent *legislation*, however, Congress has proceeded formally through the legislative process. A mere

---

[15] *Zuber v. Allen*, 396 U.S. 168 (1969); *United States v. Price*, 361 U.S. 304, 310 (1960); *I.C.C. v. Railway Labor Executives Ass'n*, 315 U.S. 373, 378-79 (1942). The *Zuber* case is instructive:

> Even less deference is due silence in the wake of unsuccessful attempts to eliminate an offending interpretation by amendment. *See, e.g., Girouard v. United States* [328 U.S. 61 (1946)]. Where, as in the case before us . . . there is no indication that a subsequent Congress has addressed itself to the particular problem, we are unpersuaded that silence is tantamount to acquiescence, let alone the approval discerned by the dissent.

Zuber v. Allen, 396 U.S. at 185 n.21. As the *Zuber* Court explained, "[c]ongressional inaction frequently betokens unawareness, preoccupation, or paralysis." 396 U.S. at 185 n.21.

> statement in a conference report of such legislation as to what the Committee believes an earlier statute meant is obviously less weighty.

GTE Sylvania, Inc., 447 U.S. at 118 n.13 (emphasis in original). Since Congress did not in fact change section 361, there is no subsequent legislation and the doctrine enunciated in *Red Lion* is not germane. The other case cited by NCFA is equally unhelpful. *See Seatrain Shipbuilding Corp. v. Shell Oil Co.*, 444 U.S. 572 (1980). *Seatrain* speaks of the weight to be given the views of subsequent Congresses.[16] As *Timbers II* has pointed out, the view of the 1986 Congress was certainly not favorable to the *American Mariner* view. *See Timbers II*, 808 F.2d 364-370. If the view of the 1986 Congress is to be given any weight, that weight should contribute to upholding the *Timbers* view, not dismantling it.

If silence in the legislative history is a barometer of Congressional consent, then the silence of Congress in 1984 when it passed the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (codified as amended in scattered sections of 11 and 28 U.S.C.) [hereinafter "BAFJA"] commends the *Timbers* view to a much greater extent than the Family Farmer Bankruptcy Act contradicts it. The BAFJA contained a wide ranging series of amendments to the Bank-

---

[16] The only case which the *Seatrain* case cites for its proposition is *N.L.R.B. v. Bell Aerospace Co.*, 416 U.S. 267 (1974). *See Seatrain*, 444 U.S. at 596. The *Bell Aerospace* case speaks of the weight accorded subsequent *legislation* and cites as its authority the *Red Lion* case, discussed above. Thus the distinction pointed out by the Court in the *GTE Sylvania* case would apply here as well.

ruptcy Code, including consumer credit amendments, grain storage facility amendments, leasehold management amendments, timeshare amendments, and several others. Although the vast majority of cases addressing adequate protection decided before 1984 supported the *Timbers* view, *see Timbers I*, 793 F.2d at 1410-11, and the BAFJA was intended to be an overhaul of the Bankruptcy Code, no change was made by the BAFJA to sections 361 and 362 concerning the concept of adequate protection.

IV. THE STATUTORY SCHEME OF THE BANKRUPTCY CODE

A. The Interest Provisions of the Bankruptcy Code

Glaring inconsistencies and inequities can be seen when one attempts to harmonize the interpretation of adequate protection of the *American Mariner* view with the entire statutory scheme of the Bankruptcy Code.

Section 502(b)(2) of the Bankruptcy Code states explicitly that a claim cannot include interest payments that have not matured as of the date of the filing of the petition. The section reflects long standing policy under both the Bankruptcy Act and the Bankruptcy Code that, when a debtor becomes insolvent and unable to pay even his principal obligations, it would be inequitable to allow the payment of interest on claims.[17] This prohibition includes interest on undersecured claims. *Vanston*, 329 U.S. 156, 164; *Group of Institutional Investors v. Chicago, M., St. P. & P. Ry. Co.*, 318 U.S. 523, 573 (1943). Such long standing policy was codified in section 502(b)(2) of the Bankruptcy Code adopting prior decisions of this Court. Compensating a creditor for lost "opportunity costs" as adequate protection is in clear conflict with section 502(b)(2). Surely Congress did not intend to eliminate interest payments through the mechanism of section 502(b)(2) only to have them paid as adequate protection payments under section 361.

---

[17] *See Nicholas v. United States*, 384 U.S. 678, 682 (1966); *City of New York v. Saper*, 336 U.S. 328, 330-32 (1949); *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163-64 (1946); *Group of Institutional Investors v. Chicago, M., St. P. & P.R. Co.*, 318 U.S. 523, 573 (1943); *Ticonic Nat'l Bank v. Sprague*, 303 U.S. 406, 411 (1938); *American Iron & Steel Mfg. Co. v. Seaboard Airline Ry.*, 233 U.S. 261, 266 (1941); *Sexton v. Dreyfus*, 219 U.S. 339 (1911); *Thomas v. Western Car Co.*, 149 U.S. 95, 116-17 (1893).

The Petitioner makes two inconsistent arguments attempting to reconcile section 502(b)(2) and section 361 of the Bankruptcy Code. First, Petitioner argues that lost "opportunity costs" are not interest. Lost "opportunity costs" are defined as money received upon the reinvestment of funds derived from the sale of collateral. Given this definition, it is difficult to conceive how lost "opportunity costs" could be anything other than interest. *See Timbers I*, 793 F.2d at 1382 n.1.

If one assumes that lost "opportunity costs" are not interest, some disturbing results follow. There would be no reason why oversecured creditors could not get lost "opportunity costs" in addition to accruing interest on their claims as allowed by section 506(b). If they are not part of a secured creditor's claim, an oversecured creditor would have an equitable right to receive them. However, this result would allow the oversecured creditor to receive more than the "benefit of its bargain" since it would be receiving money as if it had reinvested its proceeds while also accruing interest as if no reinvestment had occurred.

There is also no reason why an unsecured creditor could not receive lost "opportunity costs." It could easily

be argued that an unsecured creditor has an equitable interest in property since, absent the automatic stay, it could have obtained a judgment and levied on property of the estate. If lost "opportunity costs" are not interest and not prohibited by section 502(b)(2), and if section 361 allows entities with equitable interests in property to receive lost "opportunity costs," then "interests" of unsecured creditors should be included as well. Chief Judge Clark makes this point about unsecured creditors in his concurring opinion in the *Timbers* case concluding that the rights of both undersecured and unsecured creditors are equally impaired by bankruptcy proceedings. *Timbers II*, 808 F.2d at 374 (Clark, C.J., concurring). The obvious end result of these newly acquired rights of oversecured, undersecured, and unsecured creditors completely dismantles the effect of the automatic stay. It in fact reinstitutes the race of diligence by creditors for the debtor's assets. The only difference is that the race now takes place in the bankruptcy court by way of motions for relief from stay. *See Timbers I*, 793 F.2d at 1409.

If lost "opportunity costs" are not considered interest and are not considered part of a creditor's claim, then they become an outright penalty on the estate. In *Vanston*, this Court had before it the issue of whether interest on interest should be allowed in a bankruptcy case. The Court concluded that it was quite likely that the extra interest covenant was akin to a penalty to induce prompt payment of simple interest. The Court reasoned that since the trigger for the obligation to pay interest on interest was suspended by the court at the commencement of the bankruptcy case, it would be inequitable to allow the creditor to receive interest on interest. The *Vanston* Court concludes that "legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay." *Vanston*, 329 U.S. at 166-67. Lost "opportunity costs" function in the same way as the interest on interest provisions prohibited by the ***Vanston*** Court. They represent a penalty for a delay in payment when the obligation of the debtor to pay and the right of the creditor to enforce its remedy for delay are both suspended by the bankruptcy laws. Thus, Supreme Court authority supports the proposition that penalties imposed because of delays engendered by bankruptcy laws will not be enforced in bankruptcy.[18]

Petitioner further argues that if lost "opportunity costs" are interest, the equitable principles surrounding the development of the law codified in section 502(b)(2) allow for the revival of the interest payments. The *Timbers* case includes an analysis of the interest provisions of the Bankruptcy Code and the background of the equitable principles underlying the interest provisions of the Bankruptcy Code. *See Timbers I*, 793 F.2d at 1385-87. *Timbers* clarifies that certain exceptions to the prohibition of interest developed in prior case law were carried forward into the Bankruptcy Code and certain of the exceptions were not. However, there never existed a general equitable

---

[18] The Petitioner even goes so far as to state that lost "opportunity costs" are not interest because they are to be applied to the unsecured portion of an undersecured creditor's claim. Brief for Petitioner at 38. This statement shows exactly how unconvincing the Petitioner's arguments are. For in straining to avoid the obvious implications of section 502(b)(2) of the Bankruptcy Code, the Petitioner comes up against another equally venerable principle that unsecured claims are to be paid through a plan of reorganization and not before. Somehow, the Petitioner would have us believe that an undersecured creditor does not have to abide by the laws embodied in the Bankruptcy Code as all other creditors do.

exception for the allowance of some postpetition accrual of interest and it would not be a wise policy on the part of this Court to engraft such an exception into the Bankruptcy Code.

Petitioner also argues that the primary holding in the *Sexton* case allows for the revival of postpetition interest in this case. *See* Brief for Petitioner at 45-47. The *Sexton* case dealt with the liquidation of a bankruptcy estate. *Sexton v. Dreyfus*, 219 U.S. 339, 340 (1911). The secured creditor had possession of its collateral and was free to sell it. The holding of the case is that the claim of the creditor was fixed as of the date of the filing of the petition initiating the bankruptcy case and, if the creditor was undersecured at that point in time, it would not be entitled to interest on its debt. *See id.* at 341. What a creditor does with its collateral after its repossession is irrelevant. It is difficult to understand how this holding is inconsistent with the *Timbers* view. At any point in time at which a creditor is entitled to repossession of its collateral, its post-repossession conduct remains irrelevant under the Bankruptcy Code. *Sexton* also stands for the proposition that when the collateral produces income, a creditor is entitled to postpetition interest to the extent of the income produced postpetition. This exception to the prohibition of the accrual of postpetition interest was not carried forward into the Bankruptcy Code. Therefore, this part of the *Sexton* case is not relevant to the Court's consideration of the question before it. To reintroduce this judicially created exception after passage of the Bankruptcy Code would clearly be an attempt at judicial legislation.

Lastly, the Petitioner argues that lost "opportunity costs" are interest which are also included in a claim as defined in section 506(a) of the Bankruptcy Code. Brief for Petitioner at 42-43. In this way, they are entitled to adequate protection under section 361. There are numerous shortcomings to this analysis. First, they cannot be part of the claim pursuant to section 506(a) since they are not part of the estate's interest in the property as required by section 506(a). Second, it is clear that section 502(b)(2) would cut them off since we are now assuming that they are interest. Third, they would cause the claim to be increasing with the passage of time and therefore section 361, which deals with a decrease in a creditor's interest, would not apply. Fourth, the creditor's interest would then equal its claim which is inconsistent with the prior argument of the Petitioner. True adequate protection payments are *subtracted* from a claim as compensation for a decrease in the value of the claim.

Section 506(b) codifies an important exception to the basic policy requiring disallowance of postpetition interest on claims in bankruptcy. Such exception allows a secured creditor to accrue postpetition interest on its claim when the value of its collateral is sufficient to cover its prepetition debt (principal and interest) as well as postpetition interest. Although the origins of the justification for this exception are not clear, they rest on the same equitable considerations found in the *Vanston* case.[19] This exception is *not* grounded upon the theory that oversecured creditors are entitled to lost "opportunity costs"

---

[19] For a discussion of the history behind the allowance of postpetition interest in Chapter 11 cases, see O'Toole, *Adequate Protection and Post-Petition Interest in Chapter 11 Proceedings*, 56 Am. Bankr. L.J. 251 (1982).

because they are enjoined from repossessing their collateral. Section 506(b) does not require payment of interest; it merely allows accrual of interest and payment at the time of confirmation of a plan or other distribution to the extent that the value of the collateral at that time is sufficient to cover such accrued interest after deducting expenses allowed under section 506(c). *See Timbers I*, 793 F.2d at 1407. Indeed, the purpose of sections 502 and 506 is to provide a method for distribution of assets through the allowance of claims which occurs in a Chapter 11 case in the context of the confirmation of the plan. If, under section 506(b), the most that an oversecured creditor can expect during the pendency of a reorganization case is the accrual, but not the payment, of postpetition interest, it is inconsistent and discriminatory to allow undersecured creditors to receive postpetition interest payments under the guise of adequate protection. *See Timbers I*, 793 F.2d at 1407-08; *Shriver*, 33 Bankr. at 184.

Attempting to reconcile the obvious inequity in the outcome of this situation, the Petitioner states that it is not always necessary to pay lost "opportunity costs," that they may be allowed to accrue if they are sufficiently protected either by a replacement lien as allowed by section 361(2) or some other indubitable equivalent. However, to say that lost "opportunity costs" can accrue belies their fundamental nature. Lost "opportunity costs" are a timing device. *When* they are paid is their most crucial element since they are compensation to a creditor for not receiving a payment at a specific time. If they are not paid, each unpaid installment will begin to accrue its own lost "opportunity cost" since it is the time of payment that distinguishes them from compensation for the value of the collateral. In other words, lost "opportunity costs" do not accrue, they compound. A debtor who does not pay its creditors their lost "opportunity costs" is faced with the prospect of paying interest on interest, in much the same way as the debtor in the *Vanston* case. The holding of the *Vanston* case, then, becomes relevant when an undersecured creditor seeks to "accrue" its lost "opportunity costs." *See Timbers I*, 793 F.2d at 1404 n. 43.

The rate at which lost "opportunity costs" "accrue" can only logically be the current market for the use of money. Since lost "opportunity costs" are based on a theoretical foreclosure and reinvestment of proceeds, a creditor would naturally reinvest its proceeds at the market rate. When the market rate is higher, this result becomes an additional inequity vis-a-vis the oversecured creditor who is accruing interest at its contract rate. Thus, in two important ways, lost "opportunity costs" are superior to the accrual of interest provided for oversecured creditors. A careful analysis indicates that the interest provisions of the Bankruptcy Code cannot be reconciled with lost "opportunity costs."

B. Other Inconsistent Provisions of the Bankruptcy Code

Section 1124 is clearly inconsistent with compensation for lost "opportunity costs." Said section, which allows a debtor in its plan of reorganization to reinstate a contract and decelerate the indebtedness as long as it cures all defaults, *see* Section 1124(a)(2), is clearly inconsistent with compensating a creditor for lost "opportunity costs" as adequate protection. As Judge Mabey points out, "[s]ection 1124(2) breaks the cycle of default, acceleration, foreclosure, and liquidation upon which the argument for opportunity cost is grounded." *South Village*, 25 Bankr. at 998. Professor Jackson also recognizes that "[t]he de-acceleration principle clearly is at odds with the general recognition of non-bankruptcy entitlements in bankruptcy." Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain*, 91 Yale L.J. 857, 879 n. 101 (1982). If, at the time of confirmation of the plan, a debtor chooses to exercise its right under section 1124(2) to decelerate and reinstate under circumstances where he had been required to compensate a creditor for lost "opportunity costs" as adequate protection, the debtor would be due a refund from the creditor if the adequate protection payments were more than that to which the creditor was entitled under the reinstated contract. Yet, there is no provision in the Bankruptcy Code for such a refund. *See Timbers I*, 793 F.2d at 1404-05; *South Village*, 25 Bankr. at 998.

Section 1129 does not allow a creditor's claim which has been reinstated pursuant to section 1124(2) to take advantage of the test found in section 1129(a)(7)(A) requiring that a claimant receive as much on his claim as he would receive under a Chapter 7 liquidation. This result follows from the fact that a claim which is reinstated pursuant to section 1124(2) is not considered impaired under the plan and the creditor is deemed to have accepted the plan. In fact, a creditor whose claim is reinstated at a time when current market rates are higher will receive less in a Chapter 11 reorganization than he would receive in a Chapter 7 case because, in a Chapter 7 liquidation, his debt remains accelerated and he is indeed entitled to realize on his claim and reinvest the proceeds at the higher rate. These Bankruptcy Code sections show a willingness on the part of Congress to eliminate liquidation of its claim as an alternative for a secured creditor in the context of a reorganization,[20] a willingness inconsistent with the allowance of lost "opportunity costs" as a form of adequate protection.[21]

Section 1111(b) also cannot be harmonized with the allowance of lost "opportunity costs" as adequate protection. Section 1111(b) is a protection for creditors which nonetheless alters a creditor's contractual relationship with the debtor. If a creditor has a nonrecourse loan and is undersecured at the time a plan is confirmed, without resort to section 1111(b), a debtor could pay the creditor the value of the property at a time of depressed prices, retain ownership of the property which would eventually increase in value, and leave the creditor with no ability to sue for the deficiency. Section 1111(b) gives a creditor some protection in this situation. It allows such a creditor to elect to either become a recourse lender and participate as an unsecured creditor to the extent of his deficiency, or retain his nonrecourse status but receive an allowed secured claim equal to the amount of his debt, not the value of the property. In this way, if the creditor elects to remain nonrecourse and retain his lien on the property, he is in effect being allowed to participate in the gamble that the property will increase in value as postconfirmation payments are being made. This alternative is the equivalent of a right to elect *not* to receive the foreclosure value on property securing his loan at a time of depressed market values.[22] Clearly, this election is inconsistent with allowing lost "opportunity costs" as adequate protection of a secured creditor's claim when it is a nonrecourse lender, which the Petitioner claims to be. *See South Village*, 25 Bankr. at 998-99. The other alternative is only available to a creditor if the property is not sold during the case or at confirmation. Since lost "opportunity costs" are based on a theoretical sale of the property, they are inconsistent with this alternative. A nonrecourse lender who receives lost "opportunity costs" should not also be allowed an unsecured deficiency claim under section 1111(b)(1)(A)(ii).

Section 363(e) is also inconsistent with the concept of requiring compensation for lost "opportunity costs" as adequate protection. Pursuant to section 363(e), a creditor with a lien on cash collateral is entitled to adequate protection if the debtor elects to use such cash collateral during its reorganization case. For example, as in the instant case, if a creditor has a lien on an apartment project and also an assignment of rents from the apartment project, and if, pursuant to section 363(e), the debtor seeks to use the rents on which section 552(b) allows the lender a continuing assignment, the debtor must adequately protect the lender's interest. However, recovery of lost "opportunity costs" is predicated on a theoretical foreclosure. If a lender has theoretically foreclosed on property and reinvested its sale proceeds, it would no longer have an interest in the rents from the property sold. Thus, in order to be consistent, section 363(e) would have to limit the ability of the lender to request adequate protection for use of the rental proceeds if it is also allowed lost "opportunity costs" under section 361 for the property itself. That such a provision is not included in section 363(e) is yet another indication that Congress did not intend lost "opportunity costs" to be required as adequate protection.

---

[20] It is interesting to note that section 1129(a)(7) has only had this effect since it was amended by Congress in 1984. This result shows that subsequent Congresses have been consistent in applying policy considerations that are inconsistent with lost "opportunity costs."

[21] In the case of *In re Manville Forest Prods. Corp.*, 43 B.R. 293 (Bankr. S.D.N.Y. 1984), a post-*American Mariner* court was faced with the issue of reconciling *American Mariner* with section 1124(2). In *Manville*, the debts were decelerated under section 1124(2). One creditor urged that it should be allowed to receive interest at the market rate to compensate it for its lost opportunity to reinvest the installments which were in default at the time that the debtor filed its petition. *Id.* at 296. The court emphatically rejected the *American Mariner* analysis, quoting the *South Village* illustration of the inconsistency between the thrust of section 1124(2) and the allowance of lost "opportunity costs." *Id.* at 302 n. 7. The court stated that the interest necessary to cure the default on the overdue installments would be the contract rate, and not even the postdefault contract rate unless the debt had been accelerated other than by the filing of the bankruptcy case. *See id.* at 302.

[22] The section 1111(b) election can be made until the time of the hearing on the approval of a disclosure statement. *See* Bankr. R. 3014. Since this hearing usually occurs in the later stages of the reorganization while a motion for relief from stay to receive lost "opportunity costs" would be filed in the beginning, a creditor can receive adequate protection payments and later make the section 1111(b) election.

C. Other Protections Against Delay by the Debtor

Consideration of the entire statutory scheme of the Bankruptcy Code leads to the conclusion that Congress did not intend lost "opportunity costs" to be included in adequate protection payments. The inconsistencies are simply too numerous to be ignored. Such conclusion, however, does not leave the creditor without any protection for the delay caused by the filing of the bankruptcy case. As the *Timbers* case has pointed out, there are many protection features against excessive delay built into the statutory scheme of the Bankruptcy Code. *See Timbers II*, 808 F.2d at 370-74.

It is true that in the case of a large and complex reorganization, an undersecured creditor whose collateral is not depreciating will have to endure a longer legitimate delay without compensation. These cases are rare exceptions and do not represent the norm in bankruptcy cases in many respects. All interests are disadvantaged in a bankruptcy to a larger extent, but, by the same token, all are benefitted more by a successful reorganization since there is so much more at stake. *See Timbers II*, 808 F.2d at 372.

D. Inconsistencies With the Bankruptcy Code and the Timbers View

NCFA asserts that there are numerous inconsistencies which can be found in the Bankruptcy Code if an undersecured creditor is not allowed to receive lost "opportunity costs." It points to protection features which are present in the Bankruptcy Code for the interest of other entities. Section 506(b), which has been discussed, is one example providing protection for an oversecured creditor. NCFA also points to payments that an owner of property can receive in the form of postpetition rent for the continued use of its property, arguing that since these entities have postpetition protection set out in the Bankruptcy Code, undersecured creditors should receive lost "opportunity costs" under section 362. But, undersecured creditors are not oversecured creditors, having bargained for a less secured position than oversecured creditors. Undersecured creditors are not owners of property. As stated by one court, bankruptcy does not change creditors "chameleon-like" into landlords. *See Barth Equipment Co. v. Perlstein*, 128 F.2d 253, 254 (2d Cir. 1942).

These inconsistencies in treatment among various entities under the Bankruptcy Code merely reflect differences in the rights and burdens of the entities in question. The scheme that the petitioner is attempting to engraft upon the Bankruptcy Code would eliminate all risk for the undersecured creditor and, at the same time, allow it the benefits of entities which do indeed bear risk. An owner of property bears the risk that the property will depreciate in value at all times and in a bankruptcy case in particular. The Bankruptcy Act was not so skewed in favor of the undersecured creditor, *see Barth Equipment Co.*, 128 F.2d at 254, and the language, the legislative history, and the statutory scheme of the Bankruptcy Code indicate that it preserves the balance struck under the Bankruptcy Act.

NCFA also argues that since administrative expenses are to be borne by unsecured creditors under the scheme of the Bankruptcy Code, it is inconsistent for undersecured creditors to have to bear their own costs for the delay. However, lost "opportunity costs" as a form of adequate protection cannot be an administrative expense since section 361 explicitly denies this result. Adequate protection payments under section 361 are entitled to a higher form of protection and are deliberately set apart from administrative expenses by the language of the Bankruptcy Code.

Administrative expenses are expenses which unsecured creditors bear for the process involved in a reorganization but do not necessarily include the costs associated with the delay involved. Secured parties also must bear the costs of the process which directly benefit them pursuant to section 506(c) of the Bankruptcy Code. Unsecured creditors bear their own costs for the delay involved and oversecured creditors fund them out of their collateral. The Bankruptcy Code provides a scheme where creditors of varying types bear the various costs associated with the reorganization case. It is a misleading oversimplification to conclude that unsecured creditors bear all costs in a reorganization except the costs to the undersecured creditor of its delay and that they should therefore bear those costs as well. *See Timbers I*, 793 F.2d at 1410-11.

Finally, NCFA comments that it is inconsistent that, in the case of a solvent liquidating debtor, unsecured creditors receive interest under section 726(a)(5) when no similar provision provides for an undersecured creditor's receipt of interest on its secured claim in the same situation. Analysis of section 726 shows, however, that the claims of secured creditors are simply not dealt with in that section. It is solely a means for distributing the unencumbered assets of the estate. The section of the Bankruptcy Code dealing with secured claims in a liquidation case is section 725. The legislative history to that section explains, "[t]he section is in lieu of a section that would direct a certain distribution to secured creditors." Senate Report at 96. In a liquidation case, the distribution received by a secured creditor is the property securing its claim. The Bankruptcy Code presumes that if the estate has no interest in the property, as would be the case of collateral of an undersecured creditor, then the trustee will proceed either under section 725 or will abandon the property pursuant to section 554 of the Bankruptcy Code. In either case, it is contemplated that the trustee will return the property to the secured creditors following a short delay, after which the undersecured creditor can begin the process of securing for itself its lost "opportunity costs."

In answer to this objection as well, the scheme of the Bankruptcy Code sets forth differing remedies for differing types of claims. If the Petitioner and its amici believe that undersecured creditors are being disadvantaged by the structure of the Bankruptcy Code, their solution is to approach Congress and forge a new balance through the legislative process and not to urge this Court to change the result by judicial fiat.

V. CONCLUSION

The *American Mariner* view of adequate protection fundamentally misinterprets the process of reorganization. It is simply not the case that secured creditors do not bear risks in a reorganization case. As Judge Randall points out,

> Finally, the leading Supreme Court cases on post-petition interest, such as *Vanston*, "indicate[] that secured creditors must also share some of the risks of the rehabilitation process." As things stood before *American Mariner's* interpretation of the adequate protection provisions, each creditor—secured or unsecured—bore its own cost caused by the delay inherent in a bankruptcy proceeding. . . . Before *American Mariner*, therefore, the risk of failure of a reorganization proceeding was borne by all creditors.

Timbers I, 793 F.2d at 1410 (citation omitted). Although all creditors would like to be in a position where they bear no risks, the Bankruptcy Code is simply not structured in such a way as to eliminate risks for any creditor.

The Petitioner attempts to convince the Court that undersecured creditors do not benefit from a reorganization. Since an undersecured creditor possesses an unsecured claim and since everyone seems to agree that unsecured creditors benefit from reorganization, an undersecured creditor will benefit, at the very least, to the extent of its unsecured claim. Particularly in the case of a nonrecourse lender, the Bankruptcy Code even goes as far as to create an unsecured claim for the benefit of the undersecured creditor. *See* Section 1111(b). However, secured creditors—even partially secured—benefit from a reorganization. Presumably, secured creditors enter into transactions with their debtors with the expectation that the debtor will prosper and will pay off its obligation in the ordinary course of its business. The creditor does not bargain for the right to foreclose as a preferred conduct but only as a last resort in the event that the debtor does not perform as expected. Therefore, it must be a benefit to a secured creditor when a reorganization allows the debtor to complete its contract as contemplated or in some modified form. A foreclosure represents a failure in the relationship and is not the desired result for either the creditor or its debtor. An undersecured creditor in particular benefits from a reorganization because its security has proven inadequate for its purpose. *See Timbers II*, 808 F.2d at 373. To argue that an undersecured creditor should not have to bear any risk as to the secured portion of its claim is a request for the best of both worlds, that it should gain all the benefits that accrue to a secured creditor in a reorganization but not bear even as much risk as an oversecured creditor which has better protected itself.

Allowing a creditor to receive lost "opportunity costs" permits a creditor to receive more in a bankruptcy than under its original contractual provisions. In receiving *American Mariner* payments, the creditor is theoretically exercising an option under its contract to end the contractual relationship with the debtor, foreclose on the collateral, and invest the money elsewhere. Under the original contract, such an election to foreclose is irrevocable. But under the Bankruptcy Code, as presently enacted, an undersecured creditor's receipt of lost "opportunity costs" would not eliminate its right to demand adequate protection under section 363(e) for the proceeds of the property on which it has theoretically foreclosed, make the election and claim an unsecured deficiency under section 1111(b), participate in a plan of reorganization insisting on going concern value for its collateral, or, at the debtor's election, have its contract reinstated. In other words, the foreclosure "election" becomes revocable. Thus, because of the structure of the Bankruptcy Code, an undersecured creditor who receives payments for lost "opportunity costs" receives far more than the benefit of its contractual bargain.

In order for lost "opportunity costs" to fit within the scheme of the Bankruptcy Code, a creditor would have to make an election at the time of the motion for relief from stay asking for lost "opportunity costs." Receipt of lost "opportunity costs" should require the creditor to forego any rights under section 363(e) to protection for the proceeds of the property in question, any rights to claim an unsecured deficiency or to make the election under section 1111(b), and any right to demand going concern value for its collateral should a plan of reorganization be proposed. Such an election would be much more consistent with the benefit of a creditor's bargain as it relates to its foreclosure rights. Any amendment to section 361 would require at least these comprehensive amendments to other sections of the Bankruptcy Code; such amendments are more appropriately made by Congress than by the judiciary.

The Bankruptcy Court in the instant case commented, "[i]f the Debtors cannot even fund the present value of foreclosure rights in the collateral, they have little equitable [c]laim to a right to reorganize." *In re Bear Creek Ministorage*, 49 Bankr. at 459. This statement sets forth the policy that the Bankruptcy Court in the case at bar wishes to have embodied in the Bankruptcy Code. Proponents of the *American Mariner* view have seized on generalized references in the legislative history in order to superimpose upon the Bankruptcy Code the statutory scheme which they believe should be followed. See *Timbers II*, 808 F.2d at 370; *Timbers I*, 793 F.2d at 1384. However, as the Supreme Court has repeatedly stated, "generalized references to the 'remedial purposes' of [a legislative enactment] will not justify reading a provision 'more broadly than its language and the statutory scheme reasonably permit.'" *Touche Ross*, 442 U.S. at 578. In reversing the Court of Appeals, the Supreme Court in *Touche Ross* stated that "[t]he ultimate question is one of congressional intent, not one of whether this court thinks that it can improve upon the statutory scheme that Congress enacted into law." *Id.*

WHEREFORE, for the reasons stated, Respondent respectfully requests that the Supreme Court of the United States affirm the judgment of the United States Court of Appeals for the Fifth Circuit in all respects.

Respectfully submitted this 30th day of September, 1987.

Daphne Levey
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

Attorney for Respondent

Of Counsel:

Leonard H. Simon
Timothy J. Henderson
Pendergraft, Elam & Simon
1400 Post Oak Blvd., Suite 600
Houston, Texas 77056
(713) 850-7766

REPLY
BRIEF

Supreme Court, U.S.
FILED
NOV 19 1987
JOSEPH F. SPANIOL, JR.
CLERK

13

No. 86-1602

In The
Supreme Court of the United States
October Term, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,
v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Respondent.

**ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

REPLY BRIEF FOR PETITIONER

H. Miles Cohn
Schlanger, Cook, Cohn,
Mills & Grossberg
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700
Counsel for Petitioner

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
or call collect (402) 342-2831

TABLE OF CONTENTS

Page

ARGUMENT IN REPLY 1

I. REFOCUSING ON THE LANGUAGE OF THE STATUTE: ADEQUATE PROTECTION OF AN "INTEREST IN PROPERTY" BY REQUIRING COMPENSATION TO THE EXTENT THAT THE AUTOMATIC STAY "RESULTS IN A DECREASE IN THE VALUE" OF THE INTEREST 1

A. *What is the "Interest in Property" that is Entitled to Adequate Protection?* 2

B. *What is the "value" of the interest in property entitled to protection, and is this "value" decreased by delay in its enforcement?* 4

II. REASSESSING THE DEBTOR'S BURDEN: THE MEANS OF PROVIDING ADEQUATE PROTECTION 9

III. ADDRESSING THE INEQUALITY BETWEEN SECURED AND UNSECURED CREDITORS: WHY SECURED CREDITORS DO NOT SHARE THE COSTS OF A BANKRUPTCY PROCEEDING 13

TABLE OF AUTHORITIES

Cases

	Page
Bigheart Pipeline Company vs. United States, 600 F. Supp. 50 (N.D. Okl. 1984)	2
Chemical National Bank vs. Armstrong, 59 F. 372 (6th Cir. 1983)	15
In re Curtis, 9 B.R. 110 (Bkrpcy. E.D. Pa. 1981)	10
In re Fry Brothers, 52 B.R. 175 (Bkrpcy. S.D. Ohio 1985)	10
Helvering vs. Safe Deposit & Trust Company of Baltimore, 316 U.S. 56, 86 L.Ed. 1266, 62 S. Ct. 925 (1942)	2
Hernandez vs. O'Neal Motors, Inc., 480 F. Supp. 491 (N. Mex. 1979)	2
Louisville Joint Stock Land Bank vs. Radford, 295 U.S. 555, 79 L.Ed. 1593, 55 S. Ct. 547 (1935)	15
In re Nevada Towers Associates, 14 C.B.C. 146 (Bkrpcy. S.D. N.Y. 1977)	11
In re Pitts, 2 B.R. 476 (Bkrpcy. C.D. Cal. 1979)	10
Rickenberg vs. Commissioner of Internal Revenue, 177 F.2d 114 (9th Cir. 1949)	2
In re Roane, 8 B.R. 997 (Bkrpcy. E.D. Pa. 1981)	11
Ticonic National Bank vs. Sprague, 303 U.S. 406, 82 L.Ed. 926, 585 S. Ct. 55 (1938)	15
In re Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380 (5th Cir. 1986) (panel opinion)	5
In re Timbers Inwood Forest Associates, Ltd., 49 B.R. 454 (Bkrupcy. S.D. Texas 1985)	12
United States vs. Security Industrial Bank, 459 U.S. 70, 74 L.Ed.2d 235, 103 S. Ct. 407 (1982)	15

TABLE OF AUTHORITIES—Continued

United States Statutes

	Page
11 U.S.C. § 101(33)	3
11 U.S.C. § 361	*passim*
11 U.S.C. § 361(1)	4, 5, 8, 16
11 U.S.C. § 361(2)	4, 5, 8, 11, 16
11 U.S.C. § 361(3)	1, 4, 11
11 U.S.C. § 362	3
11 U.S.C. § 362(d)	3
11 U.S.C. § 362(d)(1)	*passim*

House & Senate Reports

H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977)	7
S. Rep. No. 989, 95th Cong., 2d Sess. (1978)	3
Congressional Record H11092 (September 28, 1978)	6
Congressional Record S17409 (October 6, 1978)	6

Other Authorities

2 COLLIER ON BANKRUPTCY (15th ed.) § 361.01	3

ARGUMENT IN REPLY

I.

REFOCUSING ON THE LANGUAGE OF THE STATUTE: ADEQUATE PROTECTION OF AN "INTEREST IN PROPRTY" BY REQUIRING COMPENSATION TO THE EXTENT THAT THE AUTOMATIC STAY "RESULTS IN A DECREASE IN THE VALUE" OF THE INTEREST

The argument for protecting the secured creditor from the costs of delay begins with the language of the statute. The Brief for Petitioner therefore focuses on the history and use of the term "adequate protection" (from Bankruptcy Code section 362(d)(1)), as well as the term "indubitable equivalent" (from Bankruptcy Code section 361(3)), both of which have long been interpreted in other contexts to require protection for the costs of delay. Brief for Petitioner at 13-18. While not disputing that these terms have been used elsewhere to require such protection, the Respondent and its Amici focus on the "interest in property" that is entitled to protection. They argue that this interest is nothing other than the creditor's allowed secured claim, in effect the value of the collateral at the date on which the Petition is filed. Brief for Respondent at 6-7; Brief for National Association of Credit Management at 15-17. According to the Respondent and its Amici, the secured creditor's rights to foreclose upon default, to liquidate its collateral and apply the proceeds to its debt at a specified time, are nothing but "state law contractual remedies that are not property rights". Brief for National Association of Credit Management at 17.

This limited interpretation of the "interest in property" to be protected does not follow from the language of the statute and is inconsistent with the plain meaning of the words used in the statute. To understand why this is so, it is helpful to refocus on the language of the statute by asking two central questions. The first question arises from Bankruptcy Code section 362(d)(1): What is the "interest in property" that is entitled to adequate protection? The second question arises from Bankruptcy Code section 361, which defines the means by which adequate protection may be provided: What is the "value" of the interest in property that is entitled to protection, and is this value decreased by delay in its enforcement?

A. What is the "Interest in Property" that is Entitled to Adequate Protection?

While the phrase "interest in property" is not defined in the Bankruptcy Code, the courts have elsewhere recognized many types or rights that constitute an "interest in property." *See, e.g., Helvering v. Safe Deposit & Trust Company of Baltimore,* 316 U.S. 56, 86 L.Ed. 1266, 62 S.Ct. 925 (1942) (the rights of a beneficiary of a trust constitutes an "interest in property" under the Internal Revenue Code); *Bigheart Pipeline Company v. United States,* 600 F.Supp. 50, 53 (N.D. Okl. 1984) (the right of an oil and gas lessee to drill or prospect constitutes an "interest in property" under the Internal Revenue Code); *Hernandez v. O'Neal Motors, Inc.,* 480 F.Supp. 491, 496 (N. Mex. 1979) (the right to unearned insurance premium returns constitutes an "interest in property" under the Truth-in-Lending Act). *Cf. Rickenberg v. Commissioner of Internal Revenue,* 177 F.2d 114, 117 (9th Cir. 1949) (the

right to manage property is not an "interest in property" under the Internal Revenue Code).

Clearly an "interest in property" is something other than the property itself. Each such interest consists of a specified right in property; the interest in property need not be the owner's interest, but may be that of a beneficiary, lessee or other party. Indeed, while not defining the phrase "interest in property", the Bankruptcy Code does recognize that the secured creditor has such an interest. Bankruptcy Code section 101(33), 11 U.S.C. § 101(33), defines the term "lien" to mean a "charge against or *interest in property* to secure payment of a debt or performance of an obligation [emphasis added]."

That the "interest in property" is something other than the property itself is also clear from the reach of sections 362(d)(1) and 361, which protect not only secured creditors but all parties with rights in property of the bankruptcy estate. *See* S. Rep. No. 989, 95th Cong., 2nd Sess. (1978) (hereinafter "Senate Report") at 49 (stating that section 362(d) is intended to protect "the interest of a secured creditor or a co-owner of property with the debtor"); 2 COLLIER ON BANKRUPTCY (15th ed.) ¶ 361.01, at 361-14 (noting that consignors and lessors are also protected by section 362(d). Curiously, the Respondent and its Amici argue that the fact that Bankruptcy Code section 362(d) protects parties other than secured creditors, such as co-owners and lessors, means that secured creditors cannot be protected for the costs of delay in the exercise of their rights. Brief for Respondent at 7; Brief for National Association of Credit Management at 14-15. But this is a non sequitur. There is no reason why protecting the value of another party's interest in property requires the court to refuse protection for the value of the secured creditor's interest in property. Bankruptcy Code section 362(d)(1) requires adequate protection for all types of interests in property, and in no way excludes secured creditors from the full measure of protection. The statute is not directed to the value of property, but rather protects the value of interests in property, whether that be the ownership interest of a co-owner or the lien of a secured creditor.

B. What is the "value" of the interest in property entitled to protection, and is this "value" decreased by delay in its enforcement?

Bankruptcy Code section 362(d)(1) requires, as a condition to the automatic stay against a party with an interest in property of the estate, that the interest be adequately protected In this case, the "interest in property" to be protected is a lien, specifically a mortgage on real property. Bankruptcy Code section 361 defines the means by which such protection can be provided, stating that protection may be assured by cash payments, by an additional or replacement lien, or by such other relief as will result in the realization of the "indubitable equivalent" of the interest in property, in this case a lien. Much argument centers around the use of the phrase "indubitable equivalent" in section 361(3); the opinions of the courts below and the briefs to this Court contain extensive discussions of the history and use of this phrase and of its import to the question at hand. But in concentrating so heavily on this disputed phrase, the language of sections 361(1) and (2) is often overlooked or misquoted. The opinions of the court below, as well as the briefs for Respondent and its Amici, state that sections 361(1) and (2) protect only against decreases in the value of the *property*. As the court of appeals reasoned; "Subsections (1) and (2) state that the creditor is protected against a decline in the value of the collateral occasioned by the use, sale or lease of the collateral by the debtor during the stay." *In re Timbers of Inwood Forest Associates, Ltd.*, 793 F.2d 1380, 1393 (5th Cir. 1986) (panel opinion). *See* Brief for Respondent at 6-7, 13-14; Brief for R. Nimmer at 6-7; Brief for National Association of Credit Management at 15-17.

But sections 361(1) and (2) are not limited to the value of *property*, nor are they limited to decreases in value caused by the *use, sale or lease* of property; rather, sections 361(1) and (2) allow adequate protection to be provided by cash payments or by additional or replacement liens "to the extent that *the stay under section 362* of this title . . . *results in a decrease in the value* of such entity's *interest in such property* [emphasis added]". The object of protection is not the value of the property itself, but is rather the value of the interest in property of the party that is stayed. That "interest in property" in some cases will be the ownership interest of a co-owner or the community interest of a spouse, and in others will be the interest of a lessor or consignor; in this case, it is the interest of a secured creditor holding a mortgage in real property of the estate.

Sections 361(1) and (2) thus protect the value of interests in property, in this case the value of a real property mortgage. Since the object of protection is the value of the lien, the issue becomes the meaning of that value and, in particular, whether that value is decreased by the delay imposed by the automatic stay. Congress did not answer this question in the legislative history, and that is perhaps why the issue raised in this case has been so hotly debated for so long.[1] But Congress did provide substantial guidance to the courts in determining the value of interests in property. That guidance is found in two statements that are clearly and repeatedly made in the legislative history. First, Congress consciously chose *not* to define the "value" that is entitled to adequate protection, but elected instead to leave this issue "to case by case interpretation and development". Second, Congress intended that secured creditors, like others with interests in property of the estate, be protected for the full value of their rights in property. Both the House and Senate Reports state clearly that secured creditors "should not be deprived of the benefit of their bargain", and that the purpose of section 361 is "to insure that the secured creditor receives in value essentially what he bargained for." H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977) at 339; Senate Report at 53. *See* Brief for Petitioner at 24-28.

The Respondent argues that the "benefit of the secured creditor's bargain" is nothing more than the value of its collateral. Brief for Respondent at 18. This suggests that the undersecured creditor has somehow bargained for its undersecured position, by agreeing to loan money on less than sufficient security. *See* Brief for National Association of Credit Management at 26 (arguing that Congress intended "that the cost of delay be shared by all creditors who did not bargain for and receive collateral of adequate value"). The fallacy in this argument is that most secured creditors have not "bargained" for an undersecured position. The typical secured lender, like United Savings, would not have made a loan on less than sufficient security and did not foresee, at the time of the loan, that the value of the security would so dramatically decrease. What the secured creditor has bargained for is a right in property to secure its claim. That right is defined by the mortgage instruments signed by the parties, which in this case entitle the secured creditor, to liquidate its collateral upon default, to apply the proceeds to a more productive use, and to do so in priority to unsecured creditors and equity interests. It is unreasonable and unrealistic to exclude the value of these rights from the value of the secured creditor's bargain, or to assert that the secured creditor has agreed to bear the costs of delay imposed by the automatic stay.[2]

---

[1] The Respondent and each of its Amici cite a joint statement of the Conference Committee that drafted the final version of the Bankruptcy Code. They contend that this statement, which was read into the record by Representative Edwards and Senator DeConcini, answers this question by explaining that the subject of adequate protection is the creditor's "allowed secured claim." Brief for Respondent at 15; Brief for Global Marine, Inc. at 21; Brief for National Association of Credit Management at 15-16 n.18; Brief for R. Nimmer at 17. The court below relied on the same statement of the Conference Committee. 793 F.2d at 1399. *Neither the briefs nor the opinion of the court below quote this statement in its entirety.* While the statement does say that adequate protection is intended "to protect a creditor's allowed secured claim", the statement also includes an example that contemplates payment of interest on secured claims. 124 Cong. Rec. H11092 (Sept. 28, 1978); 124 Cong. Rec. S17409 (Oct. 6, 1978). When read in full, the statement is somewhat confusing and surely does not address whether adequate protection covers the costs of delay imposed by the automatic stay.

Since Bankruptcy Code sections 361(1) and (2) require protection against any decrease caused by the automatic stay in the value of a lien, and since Congress intended sections 362(d)(1) and 361 to protect the full value of a lien, surely that value cannot be narrowly defined to ignore delay caused by the stay in the enforcement or exercise of the lien. The essence of the secured creditor's bargain is the right to foreclose and liquidate its collateral upon default, and then to apply the proceeds of the collateral to a more productive use. Brief for Petitioner at 30-31. The loss imposed by delay is just as real to the secured creditor as the depreciation of its collateral, which the court below acknowledges is entitled to protection. The automatic stay causes a loss of income that could have been earned on the reinvested collateral proceeds, and this loss decreases the value of the creditor's interest in property just as surely as depreciation. State law has long recognized this injury, awarding damages in circumstances where a secured creditor is temporarily prevented from exercising its lawful rights in property. Brief for Petitioner at 31-32 nn. 18-20.

---

[2] It has also been argued that the "benefit of the bargain" does not include the full value of rights in property recognized by state law because the bankruptcy law itself is "part of every 'bargain'". Brief for National Association of Credit Management at 22 n. 25. This is circular. If Bankruptcy Code sections 362(d)(1) and 361 were intended to protect only the value of those rights left intact by the Bankruptcy Code, then the secured creditor would not be entitled to *any* protection, since the automatic stay by its terms prevents the exercise of all rights in property.

The narrow interpretation of value urged by the Respondent is fundamentally inconsistent with the statute. That interpretation excludes an element of value that has long been recognized by state courts, and does so despite the clear congressional directive to protect the full value of the secured creditor's rights. Moreover, such a narrow interpretation would leave the secured creditor *less* protected than under the law as it stood before enactment of the Bankruptcy Code. Under the Bankruptcy Act of 1898, the debtor's lack of equity in collateral was almost without exception sufficient grounds for relief from the stay; thus, an undersecured creditor such as United Savings was almost invariably entitled to relief from the stay. Brief for Petitioner at 20-21. The Bankruptcy Code did expand the debtor's ability to retain property subject to a lien, but only by allowing the court an alternative to terminating the stay; pursuant to section 362(d)(1), the bankruptcy court may now *condition* the stay on adequate protection of the creditor's interest in property. Brief for Petitioner at 22-24, 24-25. Since Congress intended this protection to assure the full value of the secured creditor's interest in property, surely the protected value cannot be interpreted so narrowly as to leave the secured creditor less protected than under prior law.

II.

REASSESSING THE DEBTOR'S BURDEN: THE MEANS OF PROVIDING ADEQUATE PROTECTION

The opinion of the court below assumes that protection for the costs of delay means that the automatic stay must in all cases be conditioned on periodic post-petition payments to the undersecured creditor. As the court phrased the issue, this case presents the question whether an undersecured creditor is “entitled to receive during the [bankruptcy] proceeding periodic cash interest payments on the value of its collateral.” 793 F.2d at 1381. The court below argues that these “periodic post-petition interest payments” are inconsistent with the allocation of risks and costs in bankruptcy and that such payments place an unintended burden on the debtor. 793 F.2d at 1408-10. This theme is reiterated by the Respondent and its Amici, who argue that a requirement for periodic payments will thwart the congressional policy favoring reorganizations. *See* Brief for National Association of Credit Management at 3, 5, 24-26; Brief for Global Marine, Inc. at 22-28; Brief for R. Nimmer at 10-12. These arguments equating protection for the costs of delay with a requirement for periodic post-petition payments ignore the options open to the bankruptcy court; Bankruptcy Code section 361 allows the court wide latitude in protecting the time value of interests in property, and does not prevent reorganizations that make economic sense.

Bankruptcy Code section 361 allows adequate protection to be provided in various ways; in addition to periodic cash payments, the debtor may offer an additional or replacement lien or such other relief “as will result in the realization” by the secured creditor of “the indubitable equivalent” of its interest in property. The most common form of adequate protection is the debtor's equity in property; a sufficient “equity cushion” above the creditor's claim insures that the creditor will not be harmed by delay in the enforcement of its lien. *See, e.g., In re Fry Brothers*, 52 B.R. 175 (Bkrpcy. S.D. Ohio 1985); *In re Curtis*, 9 B.R. 110 (Bkrpcy. E.D. Pa. 1981); *In re Pitts*, 2 B.R. 476 (Bkrpcy. C.D. Cal. 1979). Even in the absence of equity, adequate protection does not always require post-petition payments. Section 361(2) allows the debtor to offer an alternative or replacement lien, and section 361(3) allows the court to fashion other forms of protection. This protection might be provided, for example, by the rehabilitation, improvement or completion of the property, *see In re Nevada Towers Associates*, 14 C.B.C. 146 (Bkrpcy. S.D. N.Y. 1977), or by a third-party guaranty, *see In re Roane*, 8 B.R. 997 (Bkrpcy. E.D. Pa. 1981). It is only in an extraordinary case such as this one—where the debtor admittedly has no equity in the sole asset of the estate, has no plan for increasing that value, has no alternative or additional lien to offer, and offers no other adequate protection—that the debtor must resort to periodic post-petition payments to avoid termination of the stay.

Moreover, protecting against the costs of delay does not require periodic payments, or any other form of adequate protection, to be commenced immediately upon the filing of a bankruptcy case. As in this case, the bankruptcy court ordinarily will find that it would have taken the secured creditor some period of time to exercise its rights outside of bankruptcy, and that the creditor has not been harmed by delay until that period of time has run; in this case, the court did not require adequate protection payments to begin until *six months* after the filing of the case, surely sufficient time to file and seek confirmation of a plan of reorganization.

Requiring the debtor to protect against the costs of delay imposed on those with interests in property of the estate is not an unreasonable burden to place on the debtor. If the property has value to the estate, it follows that the property can generate income sufficient to pay a reasonable return on its market value; that being the case, the debtor should be able to use the property and apply the income earned thereby to pay the secured creditor the costs imposed by the automatic stay. If the property is worth no more than the secured creditor's claim and does not generate income any greater than that which could be earned on liquidation, then it makes little economic sense to hold the property in the bankruptcy estate.

The most likely result of a rule requiring protection of the costs of delay is that the debtor will make reasonable economic decisions with respect to the use of property subject to a lien. This rule would require the debtor to make a choice not unlike the decision it must face with respect to a lease. If the lease has net value to the estate, such that it is worth more to the estate than the rental reserved to the landlord, then the debtor will continue to pay the rents and use the leased property; otherwise the debtor will reject the lease and leave the landlord with an unsecured claim for rejection. Likewise, if property subject to a lien has net economic value to the debtor, such that the debtor can earn more with the property than could the secured creditor on liquidation, then the debtor will choose to retain the property and pay the creditor the costs imposed by the automatic stay. This result is fair. As the bankruptcy court concluded in this case: "If the Debtors cannot even fund the present value of foreclosure rights, they have little equitable claim to a right to reorganize." *In re Timbers Inwood Forest Associates, Ltd.*, 49 B.R. 454, 459 (Bkrptcy. S.D. Tex. 1985). *See* Brief for T. Jackson at 23-25.

The burden imposed by a requirement that the secured creditor be protected from the costs of delay must also be placed in the proper context. Under the law as it existed prior to enactment of the Bankruptcy Code, this issue would not even have arisen; the undersecured creditor almost invariably was entitled to relief from the stay, whether or not the debtor was capable of making periodic cash payments. The Bankruptcy Code gives the debtor an expanded ability to use property subject to a lien, by allowing the bankruptcy court to condition the automatic stay as an alternative to terminating the stay. The debtor may now retain property that previously would have been lost, but may do so only by protecting the secured creditor against the costs of delay. While allowing the debtor this option, Congress made clear that the full value of the creditor's interest in property was entitled to protection. It would be an anomalous result to allow the debtor not only to retain property in which it has no equity, but to allow the debtor to retain and use such property without any requirement that it protect the secured creditor against the undeniable costs of delay imposed by the automatic stay.

III.

ADDRESSING THE INEQUALITY BETWEEN SECURED AND UNSECURED CREDITORS: WHY SECURED CREDITORS DO NOT SHARE THE COSTS OF A BANKRUPTCY PROCEEDING

The court below argued that the secured creditor benefits from the bankruptcy proceeding and therefore should share in the costs of the proceeding. 793 F.2d at 1410-11. The Respondent and its Amici reiterate this theme, contending that secured creditors should share the risks and costs of delay imposed by the automatic stay. Brief for Respondent at 45; Brief for National Association of Credit Management at 24-26. This is contrary to the actual allocation of costs in bankruptcy, since unsecured creditors and the debtor bear the full cost of administering the estate and operating the debtor's business. Brief for T. Jackson at 14-17. But this argument rests on a more serious misunderstanding that underlies the Respondent's case. The Respondent and its Amici contend that secured creditors are not fundamentally different from unsecured creditors; the argument is that both have an interest in property, the secured creditor having an interest in specified property and the unsecured creditor having an interest in the unencumbered remaining assets of the debtor. Brief for Respondent at 30-31; Brief for Global Marine, Inc. at 8-9. This equation of secured and unsecured creditors was also made by the court below. Judge Clark, in his concurring opinion, went so far as to state that neither secured nor unsecured creditors "has rights superior to the other." 808 F.2d at 374 (Clark, J., concurring).

In fact, the distinction between secured and unsecured creditors is fundamental. The unsecured creditor has rights *in personam* against the debtor, while the secured creditor has rights *in rem* against specified property. A creditor may have one or both such claims, and a creditor may have a claim only *in rem*. Thus, for example, the debtor may have purchased property subject to a lien but not in assumption of the debt secured thereby, or may have executed a nonrecourse secured note in payment for property, in both of which events the secured creditor will have a claim against property of the estate but no right to share in the unencumbered assets of the estate.

This Court has recognized, on a number of occasions, that the secured creditor has rights *in rem*, against specified property, and that the rights of the secured creditor are therefore superior to those of the unsecured creditor. *See United States vs. Security Industrial Bank*, 459 U.S. 70, 75, 74 L.Ed.2d 235, 103 S.Ct. 407 (1982); *Ticonic National Bank vs. Sprague*, 303 U.S. 406, 411-12, 82 L.Ed. 926, 585 S. Ct. 55 (1938); *Louisville Joint Stock Land Bank vs. Radford*, 295 U.S. 555, 588, 79 L.Ed. 1593, 55 S.Ct. 547 (1935). As the Court explained in *Ticonic National Bank vs. Sprague*:

> "But to the extent that one debt is secured and another is not there is manifestly an inequality of rights between secured and unsecured creditors, which can not be affected by the principle of equality of distribution, and interest accruing after insolvency may not be withheld on account of that principle."

303 U.S. at 411-12. Thus it is clear that the claim of a secured creditor, "who has rights in specific property, differs fundamentally from that of an unsecured creditor, who has none". *Louisville Joint Stock Land Bank vs. Radford*, 295 U.S. at 588. *See also Chemical National Bank vs. Armstrong*, 59 F. 372, 376-77 (6th Cir. 1893) (protecting the superior claims of secured creditors in their collateral, in receiverships under the National Banking Act).

Viewed in proper perspective, then, protection for the costs of delay imposed by the automatic stay gives no unfair or unanticipated advantage to the secured creditor.

The secured creditor gets something the unsecured creditor does not, but only because he has bargained for something more than an *in personam* claim against the debtor. The Bankruptcy Code allows the debtor to retain and use the property subject to the secured creditor's *in rem* claim, but requires that this use be conditioned on adequate protection of the creditor's interest in that property. While not defining adequate protection, Bankruptcy Code sections 361(1) and (2) measure such protection by the "decrease in the value" of the interest in property, in this case a lien, that is caused by the automatic stay. If the creditor's interest in property of the estate is to be taken seriously, and if it truly means something more than the unsecured creditor's general, *in personam* claim against unencumbered assets, then the secured creditor must be entitled to full protection for the lost value caused by the automatic stay.

The Petitioner therefore prays that this Court reverse the holding of the court below and remand for proceedings consistent with such reversal.

Respectfully submitted,

*H. MILES COHN
SCHLANGER, COOK, COHN,
MILLS & GROSSBERG
5847 San Felipe, Suite 1700
Houston, Texas 77057
(713) 785-1700

Attorneys for Petitioner

**Counsel of record*

AMICUS CURIAE

BRIEF

④

Supreme Court, U.S.
FILED
JUL 28 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1602

In The Supreme Court of the United States

OCTOBER TERM, 1987

UNITED SAVINGS ASSOCIATES OF TEXAS,
PETITIONER

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF FOR *AMICUS CURIAE*

THOMAS H. JACKSON
Amicus Curiae, pro se

Harvard Law School
Cambridge, MA 02138
(617) 495-3183

---

39 pp

TABLE OF CONTENTS

Summary of Argument and Introduction 1

Argument 3

I. A Secured Creditor's Interest in Collateral Presumptively Should be Measured in Light of its Rights Outside of Bankruptcy, as Required by this Court in *Butner v. United States* 3

II. The Bankruptcy Code's Treatment of Secured Creditors at the Conclusion of the Bankruptcy Process Suggests Compensating Them for the Costs of Delay During Bankruptcy 9

III. The Bankruptcy Code's Treatment of the Other Costs of the Bankruptcy Process Suggests Compensating Secured Creditors for the Costs of Delay During Bankruptcy 14

IV. The Bankruptcy Code's Treatment of Analogous Cases Suggests Compensating Secured Creditors for the Costs of Delay During Bankruptcy 15

V. Preference Law's Treatment of Secured Creditors Suggests Compensating Them for the Costs of Delay During Bankruptcy 18

VI. Compensating Secured Creditors for the Costs of Delay in Bankruptcy Does Not Require Periodic Cash Payments and is Inappropriate Where Reinstatement Occurs Pursuant to 11 U.S.C. Section 1124 19

VII. Compensating Secured Creditors in Full Does Not Interfere With Any Congressional Policy or Bankruptcy Code Section 21

Conclusion 30

TABLE OF AUTHORITIES

Cases:

In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) 5, 6, 7, 21, 28

In re American Mariner Industries, Inc., 27 Bankr. 1004 (9th Cir. Bankr. App. 1983), *rev.*, 734 F.2d 426 (9th Cir. 1984) 28

Barash v. Public Finance Corp., 658 F.2d 504 (7th Cir. 1981) 18

In re Bermec Corp., 445 F.2d 367 (2d Cir. 1981) 25

In re Bermec Corp., No. 71-8-291 (Ref. S.D.N.Y.), *aff'd*, 445 F.2d 367 (2d Cir. 1971) 25

Butner v. United States, 440 U.S. 48 (1979) 2, 5, 8

First Evangelical Lutheran Church of Glendale v. County of Los Angeles, 55 U.S.L.W. 4781 (1987) 6, 8

In re K. Pritchard Co., 17 Bankr. 508 (Bankr. S.D. Ala. 1981) .. 18

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) .. 8

In re Manville Forest Products Corp., 43 Bankr. 293 (Bankr. S.D.N.Y. 1984) 20

In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935) 13

Palmer Clay Products v. Brown, 297 U.S. 227 (1936) 18

Reading Co. v. Brown, 391 U.S. 471 (1968) 12, 14, 24

In re Roberts, 63 Bankr. 372 (Bankr. E.D. Mich. 1986) 28

SEC v. Canandaigua Enterprises Corp., 339 F.2d 147 (2d Cir. 1964) . . . 25
Sexton v. Dreyfus, 219 U.S. 339 (1911) 11, 12
In re Southern States Motor Inns, Inc., 709 F.2d 647 (11th Cir. 1982), *cert. denied*, 465 U.S. 1022 (1984) 10
In re Sullivan, 26 Bankr. 677 (Bankr. W.D.N.Y. 1982) 10
In re Timbers of Inwood Forest Associates, Ltd., 49 Bankr. 454 (Bankr. S.D. Tex. 1985) 28
In re Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380 (5th Cir. 1986) . . 4, 5, 7, 11, 12, 13, 14, 20, 22, 25, 26, 27, 29
In re Timbers of Inwood Forest Associates, Ltd., 808 F.2d 363 (5th Cir. en banc 1987) . 5, 7, 13, 17, 26, 29
United States v. Security Industrial Bank, 459 U.S. 70 (1982) 8
United States v. Universal C.I.T. Credit Corp., 344 U.S. 218 (1952) 2
Wright v. Central Life Ins. Co., 311 U.S. 272 (1940) 8
Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937) 8
In re Yale Express Co., 384 F.2d 990 (2d Cir. 1967) 25

Bankruptcy Code (Title 11, U.S.C.):

§ 361 . . 1, 3, 4, 6, 7, 8, 11, 13, 16, 19, 20, 21, 22, 25, 28, 29, 30
§ 362(a) 1, 3, 23
§ 362(d) 1, 3, 11, 25, 30
§ 364(d) 15
§ 365 . . . . 17, 20
§ 365(b) 10
§ 502 . . . . 9, 19
§ 503(b) 14, 15, 17
§ 506 4
§ 506(a) 7, 14
§ 506(b) 3, 4, 27, 28, 29
§ 507(a) 15
§ 507(b) 15
§ 547 18
§ 547(b) 18
§ 552 . . . . 15, 16
§ 552(b) 15
§ 725 . . . . 9, 14, 15, 22
§ 726 . . . . 9, 14, 15
§ 1122(a) 10
§ 1124(2) 10, 17, 20, 21, 25, 29
§ 1129(a) 10, 20
§ 1129(b) 10, 13, 20, 22, 25, 29
§ 1205(3) 16

Bankruptcy Act of 1898 (11 U.S.C.; repealed in 1979)

§ 57h 11
§ 77b 13

Bankruptcy Code Legislative History:

H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977) . . . 1, 2, 8, 9, 10, 19, 23

S. Rep. No. 989, 95th Cong., 2d Sess. (1978) . 1, 8, 21, 23, 25, 26

Uniform Commercial Code:

§ 9-504 6
§ 9-505 6
§ 9-506 6

Miscellaneous:

V. Brudney & M. Chirelstein, Cases and Materials on Corporate Finance (2d ed. 1979) 12
Collier on Bankruptcy (15th ed. 1985) 5, 17, 18
D. Cowans, Bankruptcy Law and Practice (1986 ed.) 17
T. Jackson, The Logic and Limits of Bankruptcy Law (1986) 11
Baird & Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U. Chi. L. Rev. 97 (1984) . 11, 24
Countryman, The Concept of a Voidable Preference in Bankruptcy, 38 Vand. L. Rev. 713 (1985) . . . 18
Jackson, Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules, 60 Am. Bankr. L.J. 399 (1986) 9

Trost, Business Reorganizations Under Chapter 11 of the New Bankruptcy Code, 34 Bus. Law. 1309 (1979) . 10
Note, "Adequate Protection" and the Availability of Postpetition Interest to Undersecured Creditors in Bankruptcy, 100 Harv. L. Rev. 1106 (1987) 22
Brief for the United States as Amicus Curie in Norwest Bank Worthington and Federal Land Bank of St. Paul v. James R. Ahlers, No. 86-958 . 28

In The Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1602

UNITED SAVINGS ASSOCIATES OF TEXAS, Petitioner
v.
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.

BRIEF FOR *AMICUS CURIAE*

SUMMARY OF ARGUMENT AND INTRODUCTION

The automatic stay of 11 U.S.C. 362(a) stops a secured creditor from exercising its default rights during the pendency of a bankruptcy proceeding. The secured creditor, however, has the right to have that stay lifted "for cause, including lack of adequate protection of an interest in property," 11 U.S.C. 362(d)(1). The question presented in this case is whether, as a condition of continuing the stay, adequate protection of the "value" of United Savings Associates of Texas' ("United Savings'") "interest" in its collateral pursuant to 11 U.S.C. 361 should take account of the time value of money -- of the fact that a dollar one year from now is not worth as much as a dollar today.

Amicus argues that the logical interpretation of a section requiring the protection of the "value" of a secured creditor's "interest in . . . property" includes compensating that creditor for the costs of delay. This is the only way "to insure that the secured creditor receives the value for which he bargained." **S. Rep. No. 989, 95th Cong., 2d Sess.** 53 (1978); see also **H.R. Rep. No. 595, 95th Cong., 1st Sess.** 339 (1977) (same).

There is a presumption in bankruptcy law that nonbankruptcy entitlements should be respected unless some federal policy embodied in the Bankruptcy Code requires a different result. *Butner v. United States*, 440 U.S. 48, 55 (1979). In this case, neither the Bankruptcy Code nor any bankruptcy policy suggests that, when valuing the rights of a secured creditor, one should ignore the time at which a secured creditor is entitled to exercise its rights.

Bankruptcy proceedings take time and delay is a cost like any other. To argue that the cost of a delay is not a component of adequate protection is to argue that Congress' chosen language or a bankruptcy policy requires secured creditors to bear this cost. But the entire structure of the Bankruptcy Code is premised on the idea that general creditors and those junior to them, not secured creditors, bear the costs of a bankruptcy proceeding and are entitled to its benefits. Nor does any bankruptcy policy require imposing the costs of delay on secured creditors when all other costs of bankruptcy are borne by those junior to them. The bankruptcy policy that favors reorganizations is not implicated here. Just as how a pie is divided is distinct from its size, so, too, the question of who pays for a reorganization is distinct from the question of whether it takes place. In this case, for example, the question of adequate protection has nothing to do with whether the apartment complex continues to be occupied and nothing to do with whether those whom the apartment complex employs continue to work. The adequate protection question may affect who, as among the equity investors in Timbers of Inwood Forest Associates, Ltd. ("Timbers"), the general creditors, and United Savings, ends up as the owner of the apartment building, but it will not affect what happens to the building.

Moreover, ignoring the costs of delay in valuing the secured creditor's rights is, as *amicus* will show, inconsistent with the general structure of the Bankruptcy Code and the way it treats analogous problems in four important ways. To avoid these inconsistencies, and hence to read the various parts of the Bankruptcy Code "in relation to each other," *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218, 222 (1952), *amicus* suggests that the "interest" of a secured creditor to be protected be given its logical interpretation, and the time value of money protected.

Amicus will also show why the four main arguments used to support the denial of compensation for time value during a bankruptcy proceeding -- that drawn from the legislative history; that drawn from 11 U.S.C. 506(b); that drawn from not using assets of the unsecured creditors to make secured creditors whole; and that drawn from the "rehabilitation goal" of the Bankruptcy Code -- do not justify that statutory reading.

ARGUMENT

I. A Secured Creditor's Interest in Collateral Presumptively Should be Measured in Light of its Rights Outside of Bankruptcy, as Required by This Court in *Butner v. United States*

A secured creditor has an interest in its debtor's property. This interest gives the secured creditor the right to force the sale of the property and to recover the money it is owed when its debtor defaults. The secured creditor's property interest, like every other property interest, consists of a particular right (the right to force a sale and enjoy its proceeds in priority to others) that can be exercised at a particular time (at the moment of default). Bankruptcy's automatic stay stops the secured creditor from asserting its right to force the sale of its collateral. 11 U.S.C. 362(a). The secured creditor, however, may seek relief from that stay pursuant to 11 U.S.C. 362(d). After notice and a hearing, the court must permit a secured creditor to exercise its nonbankruptcy right to foreclose upon its collateral unless the court determines that the interest of the secured party in its collateral is "adequately protected."[1] 11 U.S.C. 361 states that adequate protection may be provided by requiring the trustee, "to the extent that the stay . . . results in a decrease in the value of [the secured party's] interest in such property," to make cash payments to the secured party or to provide additional liens. 11 U.S.C. 361(1), (2). Alternatively, adequate protection may be provided by granting such other relief as will result "in the realization by the secured party of the indubitable equivalent of such entity's interest in such property," 11 U.S.C. 361(3).

---

[1] 11 U.S.C. 362(d)(1). The other ground for relief from the automatic stay, set forth in 11 U.S.C. 362(d)(2), is not at issue in this case.

This case raises the question of how the value of that property interest should be measured.[2] More specifically, this case asks whether in valuing the secured creditor's property interest a court must take into account not only the nature of the right under nonbankruptcy law (the right to force a sale and enjoy the proceeds), but must also take into account the time at which the right could be exercised under nonbankruptcy law.

All property rights have a temporal dimension. A fee simple interest in Blackacre is different from a future interest in Blackacre, because the fee can be enjoyed now and the future interest only later. Because owning Blackacre ten years hence is not the same as owning Blackacre today, one values them differently. The temporal element also figures in valuing a secured creditor's nonbankruptcy rights. Being able to enjoy the proceeds of a sale of collateral today is not the same as being able to reach those proceeds a year from now. The Bankruptcy Code contains no suggestion that these ordinary notions of value should be put aside and that only nominal values should be taken into account when it refers to the "value" of the secured creditor's property interest in 11 U.S.C. 361.[3]

---

[2] The opinion of the Fifth Circuit focuses on the undersecured creditor, and correctly notes its claim is bifurcated into a secured claim and an unsecured claim by 11 U.S.C. 506, 793 F.2d, at 1385. As adequate protection goes only to the secured portion of the claim, the issue is largely the same for over- and undersecured creditors, to which 11 U.S.C. 361 makes no distinction. Accordingly, *amicus* will simply refer to "the secured creditor." *Amicus* discusses one qualification to this, introduced by 11 U.S.C. 506(b), *infra* pp. 26-29.

[3] The Fifth Circuit opinion consistently seems to read "value" in the non-intuitive way of not caring about *when* money will be received. It acknowledges, for example, that Congress meant "to ensure that a secured creditor's interest in the value of its collateral would be adequately protected during the pendency of a reorganization proceeding," 793 F.2d, at 1381. And it cites,

This Court has recognized that "[p]roperty interests are created and defined by state law" and that "[u]nless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding." *Butner v. United States*, 440 U.S. 48, 55 (1979). Unless such a presumption existed, interested parties would have an incentive to engage in forum shopping. *Id.* A debtor that owns only a single parcel of real property, for example, might enter bankruptcy for no reason other than to delay its only creditor from exercising its state law rights, not because there was a going concern to be saved or fights among creditors to be sorted out.

To ensure that the bankruptcy proceeding can function effectively, every creditor must be stayed from exercising its actual rights. But this case is not about that departure from nonbankruptcy law. The question faced in this case is whether the Bankruptcy Code requires a departure from nonbankruptcy law when protecting the *value* of the nonbankruptcy right while it is stayed.

On its face, the Bankruptcy Code does not suggest any departure from state law as far as valuing the right of a secured creditor is concerned. The Bankruptcy

---

(continued)

apparently with approval, the statement in 2 **Collier on Bankruptcy** par. 362.01 at 362-15 (15th ed. 1985) that the right of a secured creditor is "to have the value of its secured position maintained throughout the proceeding," 793 F.2d, at 1390 n.14. See also *id.*, at 1398 (noting that the Senate Report indicated that value, not rights, were to be protected, and concluding "that the Senate version of Section 361 would have protected only against a decline in value"). While the Fifth Circuit reads these various comments as supporting its conclusion, those comments seem instead intended simply to distinguish between *rights* and the *value* of rights. One cannot protect the true "value" of a secured position without compensation for delay. This case does not involve the question of *whether* a secured creditor can be left in the same economic position if it is denied compensation for time value -- everyone agrees it is not, see 808 F.2d, at 377 (Jones, J., dissenting) -- but whether Congress mandated compensation in full or something else. Nothing in language or logic compels the Fifth Circuit's constrained definition of "value." See *In re* American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) ("plain meaning" of statute includes compensation for time value).

Code simply asks that the "value" of the secured creditor's "interest in . . . property" be adequately protected. Even in the case of ordinary property rights, valuing a property right requires taking the moment such a right could be exercised into account. For example, this Court has held that the government is liable for damages even when it only prevents a party from using its property for a period of time. *First Evangelical Lutheran Church of Glendale v. County of Los Angeles*, 55 U.S.L.W. 4781 (1987). The property interest of the secured creditor presents an even stronger case for taking into account the moment that the property interest can be enjoyed in setting a value on it.

The property rights of a secured creditor, unlike many other property rights, represent principally a means to an end. A secured creditor under state law does not have the right to keep the property it repossesses. A debtor can always force a secured party to sell it and until such a sale occurs a debtor can recover the property by repaying the loan. See U.C.C. Section 9-504 through 9-506 (1978).[4] A secured creditor, then, has only the right to use its collateral to get paid at a particular time. It follows that when a debtor files a petition in bankruptcy, a secured creditor is not so much deprived of a particular piece of property as it is deprived of the right to use that property to obtain a certain amount of money at a certain time.

That right to convert its collateral into money upon a default represents the secured creditor's principal "interest" in the debtor's property. It is hard, indeed, in construing 11 U.S.C. 361, whether subsection (1), (2), or (3), to articulate what other "interest" a secured party has that needs protection. See *In re American Mariner Industries, Inc.*, 734 F.2d 426, 431 (9th Cir. 1984) (the "right to take possession of and sell the collateral . . . are valuable rights of secured creditors, and nothing in the [legislative] reports suggest that they are not among

---

[4] The cited sections deal with security interests in personal property. There are no essential differences with real property, however, and the Fifth Circuit opinion applies to real and personal property alike.

those equitable and legal interests entitled to protection").

The rationale for protecting a secured creditor -- as all agree is the case -- when its collateral depreciates in value during bankruptcy from $100,000 to $80,000 through use or age, is that the creditor's rights have been compromised. Seen from the perspective of what a secured creditor uses collateral for, however, the costs of delay itself are no different than the costs of depreciation. The secured creditor's ultimate right under state law is to money, not to property. A creditor who is entitled under state law to $100,000 at or shortly after the time of a bankruptcy petition is not given the benefit of its bargain -- as Congress said it should -- if it receives $100,000 several years later.

Because a secured creditor's property interest is a means to payment, and not an end in itself, it makes little sense to construe statutory references to "value" as referring only to nominal values or to define a secured creditor's "interest" as limited to the physical well-being of property.[5] In light of the fact that delay in the

---

[5] See 11 U.S.C. 506(a) ("value shall be determined in light of the purpose of the valuation"). The Fifth Circuit's misconstruction of "value" (see *supra* note 3) and a secured creditor's "interest in . . . property" led it to construe 11 U.S.C. 361(3) in the wrong context. It viewed 11 U.S.C. 361(1) and (2) to be irrelevant to this case, stating "neither subsection (1) nor (2) authorizes periodic payments to a creditor whose collateral is not decreasing in value," 793 F.2d, at 1388. But those subsections speak of a "decrease in the value of" the creditor's "interest" in the property. The logical reading of these sections, wholly apart from 11 U.S.C. 361(3), is to compensate a creditor for lost value -- including time value. See *In re* American Mariner Industries, Inc., 734 F.2d 426, 431-32 (9th Cir. 1984). The Fifth Circuit then took one further misstep in analyzing the scope of 11 U.S.C. 361(1) and (2). It stated that those subsections protect a secured creditor "against a decline in the value of the collateral occasioned by the use, sale or lease of the collateral by the debtor during the stay," 793 F.2d, at 1389. The subsections, however, cover not only declines in value caused by use, sale, or lease, but, as recognized by the *en banc* dissent, 808 F.2d, at 376 n.3, also declines in value *caused by the stay itself*. See 11 U.S.C. 361(1) ("to the extent that the stay under section 362 of this title . . . results in a decrease in the value of such entity's interest in such property"); 11 U.S.C. 361(2) ("to the extent that such stay . . . results in a decrease in the value of such entity's interest in such property"). The most common decline in value caused by the stay itself is that due to delay.

Having misunderstood the concept of "value," and having misread the scope of 11 U.S.C. 361(1) and (2), the Fifth Circuit, perhaps understandably, saw no reason to read subsection (3) broader -- to have it cover time realization of money causes cognizable harm, one should not casually assume Congress meant to impose that harm without a clear indication of intent. No such indication can be gleaned either from the language Congress enacted or from the legislative history. Indeed, once one understands the nonbankruptcy rights of a secured creditor, one can only implement the Congressional concern that a secured creditor's position not be compromised in bankruptcy by compensating it for time value. See S. Rep. No. 989, *supra*, at 53 ("[s]ecured creditors should not be deprived of the benefit of their bargain"); H.R. Rep. No. 595, *supra*, at 339 (same); S. Rep. No. 989, *supra*, at 53 (adequate protection "is to insure that the secured creditor receives the value for which he bargained"); H.R. Rep. No. 595, *supra*, at 339 ("the [adequate protection] section is to insure that the secured creditor receives in value essentially what he bargained for").[6]

(continued)
value when (according to it) the first two subsections did not. But if subsections (1) and (2) are read to include in "value" the concept of time value, then subsection (3) logically includes time value as well.

[6] Finally, an interpretation of 11 U.S.C. 361 that protects time value is the only interpretation that avoids inquiry into an underlying Constitutional question of whether the failure to protect time value is a taking. See First Evangelical Lutheran Church of Glendale v. County of Los Angeles, 55 U.S.L.W. 4781 (1987). As this Court has previously noted in construing the Bankruptcy Code, an interpretation that avoids a Constitutional inquiry is favored. United States v. Security Industrial Bank, 459 U.S. 70 (1982) (in light of substantial constitutional problems a contrary conclusion would raise, "[n]o bankruptcy law shall be construed to eliminate property rights which existed before the law was enacted in the absence of an explicit command from Congress"). Compare Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937) with Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935); see also Wright v. Central Life Ins. Co., 311 U.S. 272, 278 (1940) (the Fifth Amendment protects the creditor's rights "to the extent of the value of the property"). The interpretational guide of Security Industrial Bank is particularly appropriate in considering the mandates of adequate protection, where Congress explicitly noted that it was not trying to skate close to the Constitutional line. It stated that, while "[t]he concept of adequate protection is derived from the fifth amendment protection of property interests," Congress wanted to ensure, by basing the statute "as much on policy grounds as on constitutional grounds," that "[s]ecured creditors should not be deprived of the benefit of their bargain." S. Rep. No. 989, supra, at 53. This interpretational guide is also fully consistent with that of Butner, see supra p. 5.

II. The Bankruptcy Code's Treatment of Secured Creditors at the Conclusion of the Bankruptcy Process Suggests Compensating Them for the Costs of Delay During Bankruptcy

The role of adequate protection in the context of the automatic stay can be viewed as a response to the fact that bankruptcy proceedings take time.[7] Outcomes that would result if bankruptcy proceedings were instantaneous should not be reversed or changed simply because they take time. To see why that point is important to the statutory interpretation issue involved in this case, consider what would happen if bankruptcy proceedings took no time -- if cases were filed and concluded on the same day. In such a world, there would be no need for an automatic stay and, consequently, no issue would be raised concerning the adequate protection of a secured creditor during a bankruptcy proceeding. These issues come up only because bankruptcy proceedings take time.

If the debtor were liquidating, 11 U.S.C. 725, together with an acceleration of principal provided by 11 U.S.C. 502,[8] ensures that the value of a secured creditor's rights would be respected in full. Pursuant to 11 U.S.C. 725, the secured creditor would either be given the collateral or its proceeds, and this would occur before the distribution to general creditors under 11 U.S.C. 726. No delay issues would be involved, as the secured creditor's rights would be recognized on time and in full.

---

[7] A more complete treatment of this point is developed in Jackson, Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules, 60 Am. Bankr. L.J. 399 (1986).

[8] The legislative history to 11 U.S.C. 502 notes: "bankruptcy operates as the acceleration of the principal amount of all claims against the debtor," H.R. Rep. No. 595, supra, at 352-53. Thus, 11 U.S.C. 502 treats bankruptcy as an event of default and acceleration.

The reorganization case is somewhat different. As before, if the debtor were disposing of the collateral, a secured creditor would be entitled to its collateral or the proceeds in priority to the claims of the unsecured creditors. But because the debtor may be more valuable with the asset left in place, the Bankruptcy Code provides that the secured creditor could be given, in lieu of the collateral or its proceeds, the present value equivalent of its right to the asset, 11 U.S.C. 1129(b).[9] Whether the creditor gets the collateral, its proceeds, or the present value of the collateral, its entitlement to the time value of money is recognized by the Bankruptcy Code in full.[10]

To be sure, bankruptcy proceedings are not instantaneous, but take time. But awareness of what the Bankruptcy Code itself requires after bankruptcy is helpful in construing what it requires during bankruptcy. For there is no reason why a secured creditor's entitlements *during* bankruptcy should be analyzed differently than the Bankruptcy Code analyzes them *after* bankruptcy. See *Sexton v. Dreyfus*, 219 U.S. 339, 344-45 (1911) (Justice Holmes uses an analogy of an instantaneous proceeding to decide entitlements).[11]

The relative position of two classes of creditors should not turn on how long a bankruptcy proceeding takes.[12] If secured creditors are denied time value as a component of adequate protection, the relative rights of different kinds of creditors turns on how long the bankruptcy proceeding lasts. The longer the bankruptcy proceeding, the greater the rights of the shareholders and general creditors and the fewer the rights of the secured creditors. It makes little sense to think that Congress would recognize time value as a component of a secured creditor's ultimate rights (as it has), yet make those rights contingent on the bankruptcy proceeding being over quickly. This becomes all the more evident when one recognizes that those who control the bankruptcy proceeding of a firm -- the equity owners and the general creditors -- are themselves the beneficiaries of delay.[13] If secured creditors are not compensated for the costs of delay, those that control the bankruptcy process have an incentive to take their time.[14] Providing this incentive serves no bankruptcy policy.

---

[9] See H.R. Rep. No. 595, supra, at 408 (noting present value analysis is required); In re Southern States Motor Inns, Inc., 709 F.2d 647 (11th Cir. 1982). This provision -- codifying the absolute priority rule -- applies only if a "class" rejects a plan, 11 U.S.C. 1129(a)(8), (b), and if the proponent nonetheless seeks confirmation. But since each secured creditor is generally in its own class (because its collateral and/or priority level is different from other secured parties), 11 U.S.C. 1122(a); In re Sullivan, 26 Bankr., 677, 678 (Bankr. W.D.N.Y. 1982); Trost, Business Reorganizations Under Chapter 11 of the New Bankruptcy Code, 34 Bus. Lawyer 1309, 1327 (1979), the text correctly states the entitlement of such a creditor, absent its consent to different treatment.

[10] This result, however, holds if, and only if, a decision is made to treat the secured creditor's contract as in default. Unlike the liquidation case, use of default rights as the baseline measure of entitlements can be called off by application of the reinstatement provisions of 11 U.S.C. 1124(2). This section accomplishes that result by deeming the class whose contracts were reinstated to be "unimpaired," see 11 U.S.C. 1124(2); unimpaired classes satisfy 11 U.S.C. 1129(a)(8); and only if that subsection is not satisfied are the provisions of 11 U.S.C. 1129(b) -- the absolute priority rule -- brought into play. Again, since each secured creditor is generally in its own class, it is accurate to speak of reinstating a secured creditor's contract. A similar power of reinstatement notwithstanding defaults exists for executory contracts in 11 U.S.C. 365(b). Upon reinstatement, the secured creditor's rights are measured by the terms of the ongoing contract, not by its rights on default. The effect of reinstatement pursuant to 11 U.S.C. 1124(2) on adequate protection is discussed by amicus, infra pp. 20-21.

[11] Sexton v. Dreyfus is sometimes cited for the proposition that undersecured creditors are not entitled to interest during bankruptcy, and therefore time value is not compensable. See 793 F.2d, at 1385. That inference, however, misunderstands the opinion. The secured creditor in that case was holding onto its collateral at the time of the petition, and was entitled, pursuant to Section 57h of the Bankruptcy Act of 1898, as in force at that time, to convert its collateral into money pursuant to its contract with the debtor. The delay involved in that case, accordingly, was not the delay of the bankruptcy process but the delay of the secured creditor in selling the collateral. (The analogous delay in this case would be the period during which United Savings was actually engaging in its repossession and sale remedies. That period is not, as amicus notes infra p. 28, necessarily entitled to protection under 11 U.S.C. 362(d) and 361.) Justice Holmes noted that, at the date the petition was filed, the secured party was "compelled to realise his security and look for a new investment," Sexton v. Dreyfus, 219 U.S., at 345. That issue is sharply different from the issue raised by this case, which deals with a delay in the ability of a secured creditor "to realise his security and look for a new investment" caused not by the secured creditor but by the automatic stay and the debtor's continued use of the asset.

[12] The following analysis borrows on the fuller treatment in Baird & Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U. Chi. L. Rev. 97 (1984). See also **T. Jackson, The Logic and Limits of Bankruptcy Law** Chs. 1, 2, 7 (1986).

Incentives to choose the right course of action -- immediate liquidation versus continuation -- are *inevitably* skewed if one group gains all the benefits from delay but can impose on another group some of the costs. See *Reading Co. v. Brown*, 391 U.S. 471, 478, 482

---

[13] An undersecured creditor might appear to benefit from delay if its collateral appreciated in value during bankruptcy. Under the analysis of this brief, however, a partially-secured creditor's position should be frozen, if it asks for adequate protection, based on the analogy of pursuing its default rights outside of bankruptcy. See Sexton v. Dreyfus, 219 U.S. 339, 344-45 (1911) (fixing value of a secured creditor's security at the date of the petition). Since adequate protection compensates a secured creditor on the basis of the value of repossession and sale, it would be inconsistent with that to permit a secured creditor to benefit, as well, by any additional appreciation in the value of the collateral that occurs while the estate delays the secured creditor. (Had it foreclosed on and resold the collateral, the secured creditor would not have benefited from any future appreciation in the value of the collateral, just as it would not be saddled with any future loss in its value.) With that qualification in place, undersecured creditors, *qua* secured creditors, are not the beneficiaries of bankruptcy, and the statement in text is correct. See also *infra* note 31.

[14] *Amicus* notes that this case may present a striking example of that. The Fifth Circuit assumed that to require Timbers to make the payments required by the bankruptcy judge would thwart its reorganisation prospects, 793 F.2d, at 1410 n.50. But if Timbers cannot fund them now, it is not clear how it will fund them at the conclusion of this one-asset case. Timbers could meet its obligations later only if the value of its property rose. But the asset might go down in value instead of up. (The current market value of an asset reflects both possibilities. See V. Brudney & M. Chirelstein, Cases and Materials on Corporate Finance 52-66 (2d ed. 1979).) If the property goes up in value, Timbers gets the benefit; if it goes down, United Savings pays the cost. This feature explains why Timbers wants the delay, but it does not justify it. The question in this case appears to be not whether a business lives or dies. The apartment complex will continue to exist regardless of how any conflicts between United Savings and Timbers are sorted out. The issue is not whether there will be a "successful reorganisation," as much as it is who, as between Timbers and United Savings, will end up owning the property.

(1968). It is for this reason that the contrary argument -- that imposing the costs of delay on unsecured creditors and shareholders would tend to *further* delay -- cannot withstand analysis.[15]

In a plan of reorganization 11 U.S.C. 1129(b) requires that the time value of the secured creditor's claim be accounted for. If it were otherwise, the general creditors would tend to transfer the costs of the plan for keeping the firm intact from themselves to the secured creditors. Hence in a plan of reorganization, "'adequate protection' must be completely compensatory; and . . . payment ten years hence is not generally the equivalent of payment now." *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935). The same tension exists during the bankruptcy process between secured creditors and those "who have everything to gain and nothing to lose," *id.*, and Congress used the same language when describing the rights of secured creditors during bankruptcy. (Both "adequate protection" and "indubitable equivalent" derive from the postbankruptcy context. See *Murel Holding*, *supra*; see also Bankruptcy Act of 1898, Section 77B, 11 U.S.C. 616 (1976; repealed prospectively 1979).) Even if the use of the same language to confront the same tension between secured creditors and those junior to them during as well as after bankruptcy does not lead ineluctably to the conclusion that Congress intended the two periods to be treated the same, a heavy burden should be imposed on those who would argue that they should be treated differently.

---

[15] The Fifth Circuit relied on a policy argument of this sort. It argued that "[t]here would be little economic incentive for the undersecured creditor . . . to cooperate in developing a negotiated plan." 793 F.2d, at 1407. This elides the fact that such cooperation is neither necessary, see 11 U.S.C. 1129(b), as well as the baseline fact that the absolute priority rule provides that override of the secured creditor requires compensation in full, including time value costs, *id.* Such an argument, moreover, turns 11 U.S.C. 361 upside down: it turns a section admittedly designed to *protect* secured creditors into a vehicle for *coercing* their cooperation (by imposing economic harm on them). See 808 F.2d, at 377 n.5 (Jones, J., dissenting). The fact that, if time value were protected, delay "would have little adverse effect on the [secured] creditor," 793 F.2d, at 1407, presumably is the *point* of adequate protection: to keep those who will not benefit from reorganisation from paying its costs.

III. The Bankruptcy Code's Treatment of the Other Costs of the Bankruptcy Process Suggests Compensating Secured Creditors for the Costs of Delay During Bankruptcy

The Fifth Circuit, to buttress its conclusion that secured creditors should be denied compensation for time value, relied on a premise that Congress intended losses to lie where they fall in a bankruptcy proceeding: that each creditor, secured or unsecured, is required to pay for the costs (including delay) the bankruptcy process imposes on it. It stated that "the rule [is] that all creditors generally share some of the risk," 793 F.2d, at 1382. This argument, however, misunderstands the Bankruptcy Code, as the "rule" in bankruptcy is exactly the opposite. Administrative expenses -- the costs of running a bankruptcy proceeding -- are borne by unsecured creditors, not by secured creditors. See 11 U.S.C. 503(b), 506(a)(1), 725, 726. Thus, the Bankruptcy Code itself expressly places the costs of the proceeding on the unsecured creditors. Secured creditors are *not* asked to share in the administrative costs of the bankruptcy process.

Delay is a cost like any other. Delay costs should not be singled out and placed on the secured creditors. Nothing suggests that Congress intended different treatment of this -- and only this -- cost. This is particularly the case when one recognizes where the benefits of the reorganization process go. The general creditors and equity owners are the beneficiaries of the bankruptcy process. Hence, it is only natural that they bear its costs. See *Reading Co. v. Brown*, 391 U.S. 471, 478, 482 (1968) (justifying administrative expense priority for tort claims arising during bankruptcy on the rationale that "those for whose benefit the business is carried on" in bankruptcy should pay its costs). If money must be spent to hire a trustee or lawyers or accountants, general creditors must bear the cost. If money is to be spent on goods, or paid out on account of torts committed during the bankruptcy process, bankruptcy law imposes those

costs on the unsecured creditors. See 11 U.S.C. 503(b), 507(a), 725, 726. Indeed, the Bankruptcy Code goes to great lengths to ensure that the expenses of running the estate during bankruptcy do not compromise the position of a secured creditor. See 11 U.S.C. 364(d), 507(b). No reason exists for the general creditors to bear all these costs -- from legal fees through compensating those the firm injures during the reorganization process -- and then to except out a particular kind of cost associated with the property interest of secured creditors. There is no reason to conclude Congress has done so when it mandates protecting the "value" of a secured creditor's "interest" during bankruptcy, so as to ensure that it receives "benefit of its bargain."

IV. The Bankruptcy Code's Treatment of Analogous Cases Suggests Compensating Secured Creditors for the Costs of Delay During Bankruptcy

A debtor who owns Blackacre can either lease the land out and enjoy rental payments or use the land in its own business to generate revenues. If the debtor leases Blackacre, a creditor with a security interest in Blackacre, if it is entitled to the rentals as a matter of state law, remains entitled to the rentals under 11 U.S.C. 552(b). At the time rental contracts are entered into, rents are quintessential compensation for time value, and the Bankruptcy Code, through 11 U.S.C. 552, allocates such rentals to the secured creditor.[16]

---

[16] For this reason, turnover of rentals may oftentimes provide adequate protection, if circumstances do not change substantially after the rental contracts are entered into. The bankruptcy court, however, found in this case that turnover of rentals was not necessarily adequate to compensate United Savings for the loss of its right of foreclosure (including time value). This conclusion is justified if existing rentals in fact do not reflect current fair market rentals, but instead are lower. (On the other hand, if the market value of the apartment complex has dropped, because of an overbuilding of apartments in the Houston area, then fair market rentals would also drop, and might, for a period, *exceed* rentals already in place. One would expect the ultimate liquidation value of the apartment complex and fair market rentals to move in the same direction, as one reflects a time-value component of the other.) Even if the bankruptcy judge used the wrong standard in deciding that existing rentals did not necessarily protect adequate protection to United Savings, this issue (inherently fact-specific), would not be affected by a rever-

Exactly the opposite result holds, however, if the debtor keeps the property and delay is not taken into account in valuing the rights of a secured creditor. The debtor will be able to use the property without owing *anything* to the secured creditor as long as the property itself does not depreciate during the pendency of the bankruptcy proceeding. In using the property itself, however, a debtor is simply benefiting from the property directly, instead of through rental payments. One cannot justify denying the secured creditor compensation completely when the debtor uses property in its own business in the face of an explicit provision in the Bankruptcy Code that gives the secured creditor net rentals when the property is rented out. The natural reading of 11 U.S.C. 361 -- valuing the rights of the secured creditor at the moment it could exercise them under nonbankruptcy law -- is consistent with the explicit mandate of 11 U.S.C. 552 as applied to property that has been leased.

Congress embraced the idea that secured creditors are entitled to be compensated for the debtor's use of collateral during the bankruptcy proceeding when it enacted Chapter 12 of the Bankruptcy Code in 1986. Notwithstanding its concern for the family farmer, Congress still provided for adequate protection of secured creditors based on the payment of "reasonable rent customary in the community where the property is located." 11 U.S.C. 1205(3). When Congress substituted fair market rent for the "indubitable equivalent" test of 11 U.S.C. 361(3) for secured creditors whose collateral is used during the reorganization of a family farm, Congress intended that secured creditors receive at least some compensation for time value. Given the policies underlying Chapter 12, it would seem unlikely that Congress intended to impose greater burdens on family farmers than were borne by debtors generally. Yet, if 11 U.S.C. 361 is read to deny secured creditors compensation for the costs of delay, secured creditors in this respect are better off if their debtor is a family farmer in Chapter 12 than if their debtor is in Chapter 7 or 11. See 808 F.2d, at 378-79 (Jones, J., dissenting) ("farmers in the Fifth Circuit will henceforth bear a higher adequate protection burden under this 'relief' provision of the Family Farmer Act than will non-farm debtors").

Finally, when a debtor wishes to remain in possession of property under an unexpired lease prior to assumption or rejection of the lease pursuant to 11 U.S.C. 365, it is required to pay, as an expense of administration, rent at the fair market value.[17] See 11 U.S.C. 365; 503(b); 2 **Cowans Bankruptcy Law and Practice** Section 12.15 at 439 (1986 ed.) ("Trustees are not entitled to the use of the premises without charge. The claim of the lessor is one for an administrative expense under Section 503 . . . . The use by the trustee gives rise to a claim for the fair value of the use of the premises"). Just as a debtor has no right to use property for nothing when the lessor's state law right to the property has been stayed, a debtor should have no right to use property for nothing when the secured creditor's right to the property has been stayed.

All these provisions recognize the time value of money. Typically, fair market rentals will include both projected depreciation of the leased property as well as a return on the lessor's investment, 2 **Collier on Bankruptcy**, *supra*, at Par. 365.03. Even nondepreciable property, such as land, will carry a positive fair market rent because of the fact that the lessee appropriates a value of the property through the passage of time and the fact that the lessor's money is tied up in that property during that time. Thus, when Congress provides fair market rent to a party, Congress is providing compensation for time value. There is no reason to believe Congress intended less protection when the property rights of secured creditors are stayed -- for the delay in its right to repossess the property and sell it.

(continued)

sal and remand by this Court on the issue before it.

[17] If the debtor subsequently assumes the lease contract, the terms of that lease contract are reinstated. This is analogous to reinstatement of secured loans pursuant to 11 U.S.C. 1124(2), which amicus discusses infra pp. 20-21.

V. Preference Law's Treatment of Secured Creditors Suggests Compensating Them for the Costs of Delay During Bankruptcy

Under 11 U.S.C. 547 of the Bankruptcy Code, the trustee (or debtor in possession) may avoid transfers of property to creditors on account of antecedent debts if the transfer occurs within 90 days before bankruptcy, while the debtor was insolvent, and if the transfer "enables such creditor to receive more than such creditor would receive if -- (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title," 11 U.S.C. 547(b)(5). The purpose of the requirements of Section 547(b)(5) is to ensure that, before a transfer is voidable as a preference, a creditor in fact did improve its position over what it would have been in bankruptcy. See *Palmer Clay Products v. Brown*, 297 U.S. 227, 229 (1936). While subsection (b)(5) might occasionally protect an unsecured creditor (who, for example, settled its debt for fifty cents on the dollar shortly before bankruptcy and where bankruptcy would provide a payment in excess of fifty percent to unsecured creditors), its common use is in protecting payments to fully secured creditors.[18] See, e.g., *Barash v. Public Finance Corp.*, 658 F.2d 504, 511 (7th Cir. 1981) ("[p]ayments on secured claims do not diminish the estate, i.e., they do not enable a creditor to receive more than he would under the liquidation provisions of the Code"); 4 Collier on Bankruptcy, *supra*, at Par. 547.08 ("payments to a fully secured creditor will not be considered preferential

because the creditor would not receive more than in a chapter 7 liquidation").

Such a conclusion (which is longstanding), however, is inconsistent with the view that secured creditors are not entitled to compensation for the costs of delay during bankruptcy. For if the Fifth Circuit is correct about what Congress has mandated in 11 U.S.C. 361, then it is incorrect (or at least inconsistent) to conclude that secured creditors that receive payments within 90 days before bankruptcy have not improved their position on the eve of bankruptcy. A secured creditor that receives $100,000 the day before bankruptcy from the debtor on account of its secured debt is in fact in a better position than a secured creditor that will receive $100,000 one year later. For, the secured creditor that receives the $100,000 the day before bankruptcy can capture the time value of money (such as by investing it in riskless government securities), and end up with *more* than $100,000 one year later.

VI. Compensating Secured Creditors for the Costs of Delay in Bankruptcy Does Not Require Periodic Cash Payments and Is Inappropriate Where Reinstatement Occurs Pursuant to 11 U.S.C. Section 1124

Awarding compensation for time value assumes that a secured creditor's rights are measured by its default-based rights of repossession and sale. That is clearly correct in a liquidation case. A creditor's rights of repossession and sale become ripe upon an event of default. In a liquidation case, the default and acceleration are provided automatically by 11 U.S.C. 502, see H.R. Rep. No. 595, *supra*, at 352-53. Thus, in a liquidation case, there is no reason *not* to include time value as a part of the secured creditor's package of adequate protection rights.

Nothing in the adequate protection section, or in the analysis to this point, requires cash payments in order to fully protect the value of a secured creditor's rights. The Fifth Circuit was right in rejecting the

---

[18] It also will protect payments to partially-secured creditors, if the creditor is willing to apply the payment to the secured portion of its debt and relinquish its claim *pro tanto* to its collateral. Compare *In re* K. Pritchard Co., 17 Bankr. 508, 509-10 (Bankr. S.D. Ala. 1981), with Barash v. Public Finance Corp., 658 F.2d 507 (7th Cir. 1981). See also Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713, 744 (1985) ("The creditor could apply the payment to the secured part of his claim by releasing a corresponding amount of collateral").

requirement of periodic cash payments, which is the providence of 11 U.S.C. 361(1), not of 11 U.S.C. 361(2) or (3). All that is required is leaving the secured creditor with a package of rights that, consistent with 11 U.S.C. 361(3) (which excludes administrative expense priority from the scope of possibilities), gives it, in present value terms, the same amount that exercise of its nonbankruptcy default rights would give it.

Adequate protection analysis that stops here, however, is incomplete. Assuming a decision has been made to reinstate the loan pursuant to 11 U.S.C. 1124(2), it is inappropriate to continue to look to a default-based adequate protection analysis. Following reinstatement, the secured creditor's rights in the postbankruptcy period are set by its non-default contract rights. 11 U.S.C. 1124(2) and 1129(a)(8) (calling off 11 U.S.C. 1129(b)). This postbankruptcy result should inform adequate protection analysis. When a contract is reinstated, the premise is that there has been no default and, absent a default, a secured creditor's rights should be measured by the terms of its ongoing contract, not by its rights of repossession and sale. See *In re Manville Forest Products Corp.*, 43 Bankr. 292, 302 n.7 (Bankr. S.D.N.Y. 1984). This is true during bankruptcy as well as after it.

To be sure, adequate protection issues in a Chapter 11 case are likely to arise before a decision whether to reinstate the loan has been made. This, however, causes no insurmountable problems, nor does it require courts to "invent a refund procedure," 793 F.2d, at 1404.[19] In resolving an adequate protection issue, provision can and should be made for an "either/or" form of protection until the decision is made whether to reinstate the loan. In the case of reinstatement, the protection is provided by the process of reinstatement itself, for if the debtor is unable to pay over the accrued payments (with, it follows from what has been said, interest at the market rate),[20] then the loan cannot be reinstated, 11 U.S.C. 1124(2)(A), and must be treated as in default. As for the other contingency, where the decision ultimately is made either to liquidate the debtor or to reorganize the debtor but not to reinstate the loan pursuant to 11 U.S.C. 1124(2), liquidation-based adequate protection should be provided in the interim. This requires either accruing (in a protected way) market rate interest on the present liquidation value of the collateral or making periodic cash payments designed to reach the same result (payments that would have to be returned should the loan ultimately be reinstated and to the extent that they exceeded the payments due in the interim under the reinstated loan).[21] The range of choices, however, is broad, as is evident by the inclusion of 11 U.S.C. 361(3) in addition to the choices of 11 U.S.C. 361(1) and (2).

VII. Compensating Secured Creditors in Full Does Not Interfere With Any Congressional Policy or Bankruptcy Code Section

In this last section, *amicus* would like to address the arguments that have been advanced for a contrary reading of 11 U.S.C. 361. In addition to those already touched on in this brief, the argument against protecting secured creditors from the costs of delay has four major parts. The first part of the argument against including the costs of delay as a component of adequate protection is one based on a perceived conflict between the costs of providing such protection and a policy of the Bankruptcy Code. If secured creditors were compensated for the costs of delay, it is argued, reorganizations would be less likely, and the "rehabilitation goal" of the Bankruptcy Code would be thwarted. See, *e.g.*, 793 F.2d, at 1408-11; 808 F.2d, at 370-74; Note, *"Adequate Protection" and the Availability of Postpetition Interest to Undersecured Creditors in Bankruptcy*, 100 Harv. L. Rev. 1106, 1119-21 (1987).

---

[19] A similar problem would be faced if a debtor, who had been paying market rentals for use of leased property, then decided to assume the property pursuant to 11 U.S.C. 365.

[20] The reason for including market rate interest on accrued, but unpaid, contract payments in the cure required by 11 U.S.C. 1124(2), stems from the notion of returning the creditor to the status quo ante of a loan that was not in default. See S. Rep. No. 989, *supra*, at 120 ("The holder of a claim . . . who . . . is restored to his original position . . . has no cause to complain"). To do this, payments that were not made in the interim would require market rate interest for *their* lost time value.

[21] Thus, in *In re* American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984), where the adequate protection issue was first raised while the debtor was hoping to reorganize, the default-based adequate protection payments that were ordered should have been considered contingent. As the case actually turned out -- where the debtor liquidated -- the contingency was removed. The refund approach, should the amount of liquidation-based adequate protection exceed the reinstatement amounts due under 11 U.S.C. 1124(2), is, however, not the only solution. If, for example, a secured creditor has been accruing a liquidation-based claim under an adequate protection order, secured by a new lien on other assets of the debtor, one could simply cancel that claim and its associated lien.

An argument that the rehabilitation goal of bankruptcy law requires that secured creditors not be compensated for delay is wrong on several grounds. If such a policy required undercompensating secured creditors, one would expect to see it enacted in the postbankruptcy period as well. But, as already noted, the Bankruptcy Code clearly provides otherwise. See 11 U.S.C. 725, 1129(b). Because of that, Timbers will be forced eventually, as a condition of keeping the apartment complex in this case, to provide United Savings with a package of rights whose present value equals or exceeds the compensation involved in this case. The argument, then, must be that providing the same result during the pendency of the bankruptcy proceeding only produces liquidations when the preferred course would be continuation. Cast in that form, the argument cannot stand.

In the first place, reorganizations are not always desirable. There is no point to rehabilitate firms that make buggy whips no one wants. When there is no "going concern surplus," a reorganization is inappropriate because the assets are worth more if sold piecemeal and used by a variety of third parties than they are if kept together and run as currently used. The creditors as a group -- secured and unsecured -- are better off in such

cases if the company liquidates.[22]

To be sure, if a firm's assets are worth more together than broken apart, the creditors as a group are better off if the assets are kept together. The core purpose of the automatic stay of 11 U.S.C. 362(a) is to assist in keeping those assets together and to realize that goal. Because of that, the House Report correctly notes that "[t]here may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws." H.R. Rep. No. 595, *supra*, at 339.

It would be wrong, however, to assume that because recognition of *actual rights* might undermine bankruptcy's collective proceeding, recognition of the *value* of those rights leads to the same result. There is a distinction between rights and the value of those rights -- a distinction that the legislative comment recognized by continuing that "[t]hough the creditor might not receive his bargain in kind, the purpose of the [adequate protection] section is to insure that the secured creditor receives in value essentially what he bargained for," H.R. Rep. No. 595, *supra*, at 339; see also S. Rep. No. 989, *supra*, at 53 (same).[23]

When one respects the value of a secured party's right, but not the right itself, the asset remains in place. If it is indeed the case that the assets as a group are worth more together than apart, then it follows that the secured creditor can be given the present value of its default rights -- liquidation value -- *in full* and still have something left over for the unsecured creditors. *It is, indeed, tautological.* Assuming there is no reinstatement, a secured creditor's rights are measured by its rights of repossession and sale upon default. The premise of a beneficial reorganization is that the business is worth more as a going concern than if its assets are sold on a piecemeal basis. But if that is the case, there must necessarily be enough to compensate a secured creditor in full, because the rights being protected are based on the liquidation value of the collateral. One flows logically from the other. To say that there is a going concern surplus is simply to say that the sum of the liquidation values of the assets if sold one by one is less than the value of the firm if those assets are kept together as a going concern.

---

[22] Liquidating the business on a piecemeal basis may put the employees of that business out of work, but whether it will result in a net decrease in the number of people at work in the society at large is unclear, because even in a piecemeal liquidation, the assets will be placed in service somewhere else and people will be hired to run them. There is, moreover, no evidence that Congress wanted secured creditors to bear the costs a business failure arguably imposes on society as a whole when it enacted the Bankruptcy Code.

[23] This distinction between rights and values is also the logical interpretation of the statements quoted *supra* note 3.

Given that, providing a secured creditor with a package of rights whose present value equals the liquidation value of its collateral *cannot* interfere with keeping the business as a going concern when there is a going concern surplus. An argument that there is an inconsistency between protecting secured creditors in full and the rehabilitation goal of the Bankruptcy Code, therefore, confuses two separate questions: (1) The question of who should get what share of a debtor's assets; and (2) the question of what should be done with the assets.[24] Protecting the value of the rights of secured creditors will mean that general creditors or equity owners receive a smaller share of the reorganized firm. But it does not affect whether the firm remains intact.

Nor does the fact of delay, and the uncertainty that undoubtedly exists over what is the proper course of action, counsel in favor of a rule that gives the benefits of delay to one group (unsecured creditors) and some of its costs to another group (secured creditors). There is no better way to ensure that correct decisions under uncertainty are made than to give the decision-maker the benefits of the decision *and* to make it pay its costs. See Baird & Jackson, *supra*; cf. *Reading Co. v. Brown*, 391 U.S. 471, 478, 482 (1968) (giving tort victims injured during bankruptcy administrate expense priority so prepetition creditors would bear that as a cost of their decision to try to reorganize); *SEC v. Canandaigua Enterprises Corp.*, 339 F.2d 14, 21 (2d Cir. 1964) (Judge Friendly observing in bankruptcy context that those who do not bear the costs should not enjoy gain if the venture succeeds, because it would amount to "what is essentially a free ride"). Secured creditors are not the beneficiaries of a bankruptcy proceeding; they should not be asked to bear its costs. The flexibility in not forcing liquidations where they are not desirable is provided by the range of choices offered by 11 U.S.C. 361 -- which, as *amicus* has shown, does not require periodic cash payments, *supra* pp. 19-20 -- and by the contingent nature of adequate protection pending a decision to reinstate pursuant to 11 U.S.C. 1124(2). Nothing more is necessary.[25]

The second part of the argument against protecting secured creditors from the costs of delay is that the legislative history does not explicitly embrace the idea that secured creditors should be protected from the costs of delay. See 793 F.2d, at 1389-1401. Some would draw the inference from this silence that Congress did not intend to grant such protection. Yet nothing in the statute or the legislative history explicitly shows that Congress intended to deny such protection either. At crucial points, such as when it is discussing cases such as *In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1981), the legislative history leaves the issue open. See S. Rep. No. 989, *supra*, at 54.[26] Many statements, moreover, suggest (1) that Congress wanted to protect a secured creditor more than the old bankruptcy law had done, 793 F.2d, at 1394-95,[27] (2) that this protection was "based as much on policy grounds as on constitutional grounds," S. Rep. No. 989, *supra*, at 53, and (3) that the purpose of this protection was to protect the value of a secured creditor's entitlements, so as to give the secured creditor the benefit of its bargain, see statements quoted *supra* p. 8. At most, the legislative history requires courts to decide the scope of adequate protection by looking at the text of the statute and the principles that underlie it. *Amicus* has argued above that such an approach leads to the conclusion that secured creditors should be protected from the costs imposed by delay.

---

[24] More formally, it confuses the investment decision with the financing decision. A host of finance literature suggests these two issues are logically separate, and should be kept separate.

[25] The Fifth Circuit suggested, in addition, that compensating secured creditors for time value would flood the courts with adequate protection motions. 793 F.2d, at 1408 n.49, 1413. This concern, however, is both unsubstantiated and largely irrelevant. It is unsubstantiated because clear adequate protection standards may lead debtors to provide offers of adequate protection without contest (and may lead to fewer abusive bankruptcy filings, where the sole point of the filing is to delay a secured creditor). It is largely irrelevant because, since the standard is the same as that for confirmation under 11 U.S.C. 1129(b), there is no reason to fear more litigation under 11 U.S.C. 362(d) and 361 than one would expect at the time of confirmation.

[26] Neither Bermec nor In re Yale Express Co., 384 F.2d 990 (2d Cir. 1967), nor the other cases cited by the Senate or House Reports, expressly deny compensation for time value, as the issue tended not to be cast in those terms. See, e.g., In re Bermec Corp., No. 71-B-291 (Ref. S.D.N.Y.), aff'd, 445 F.2d 367 (2d Cir. 1971). The cases, instead, dealt with whether the actual rights of

The third part of the argument for rejecting the costs of delay as an element of adequate protection is

---

(continued)
secured creditors could be suspended in bankruptcy and replaced with something else. That distinction is sound, see *supra* pp. 23-24. But it is hard, therefore, to read these cases as actually rejecting the notion that delay itself causes compensable injury.

[27] The Fifth Circuit relies on these changes, and in particular, the expedited relief procedures for relief from stay motions, 793 F.2d., at 1405-07, to suggest that Congress had responded to the secured creditors' concern with delay in other ways. But speedy relief motions accomplish nothing vis-a-vis the costs imposed by delay itself if such delay is not a compensable injury. In its *en banc* opinion, moreover, the Fifth Circuit suggested that the remedy for secured creditors lay not in statutory provisions providing adequate protection, but in motions to dismiss, tight supervision by bankruptcy judges, and the like. 808 F.2d, at 370-74. This argument, however, in addition to proving too much (it would have been equally available against the granting of *any* protection to a secured creditor), is perhaps too draconian as well. Cases where reorganisation is a realistic possibility may in fact still entail substantial quantities of time to negotiate. The speed necessary to protect the rights of a secured party not entitled to time value compensation may be inconsistent with the time needed to sort out issues facing the creditors and equity owners generally. A court should not be required to terminate a bankruptcy proceeding to protect a secured creditor harmed by delay when the unsecured creditors and equity owners still wish to continue it. But to give the creditors and equity owners the correct incentive to reach the right decision as between continuation and liquidation, it is important that they not be able to gain the benefits of delay while imposing its costs on the secured creditors. That is all opportunity-cost-based adequate protection is doing.

another negative inference. 11 U.S.C. 506(b) provides that a secured creditor whose collateral is worth more than the amount of the debt has a secured claim not only for the money lent, but also for interest at the contract rate "and any reasonable fees, costs, or charges provided for under the agreement." One can argue that interest compensates a secured creditor for the costs of delay. Hence, when Congress decided to grant contractual interest to oversecured creditors in 11 U.S.C. 506(b), the argument continues, it also decided implicitly to deny compensation to undersecured creditors for the costs of delay. See 793 F.2d, at 1381, 1407-08.

This argument, however, turns on equating interest at the contract rate with compensating secured creditors for the costs of delay. The two are not the same. 11 U.S.C. 506(b) applies from the moment of bankruptcy and regardless of whether the secured party requests relief from the automatic stay. The gist of this section is that, when a creditor is oversecured, all of the collateral benefits it received in its loan agreement remain in effect. 11 U.S.C. 506(b), in other words, functions as an automatic safe-harbor by providing a minimum level of protection for the oversecured creditor. Such a creditor can ask for adequate protection, but it will receive interest at the contract rate and collection costs as provided in the contract at the end of the bankruptcy proceeding, whether it makes such a request or not.

The negative inference to be drawn from 11 U.S.C. 506(b) for undersecured creditors is straightforward enough. The undersecured creditor lacks a safe-harbor. Absent going to court, the undersecured creditor will receive at the end of the bankruptcy proceeding only its secured principal. Unlike the oversecured creditor, interest at the contract rate will cease to run the moment the petition is filed and it will not receive its costs. To say the undersecured creditor lacks a safe-harbor, however, is not to say it enjoys no protection at all. But if the undersecured creditor wants protection, it must go to court and seek relief from the automatic stay. Moreover, any protection it receives is independent of what was provided for in the loan agreement. For example, a court would calculate the costs of delay bankruptcy imposes based on a market rate of interest, which may be lower than the contract interest rate.

Moreover, the undersecured creditor that seeks adequate protection is compensated only for the costs of the delay *bankruptcy* brings. One measures its loss not necessarily from the moment that the bankruptcy petition is filed (as is the case for the oversecured creditor under 11 U.S.C. 506(b)), but perhaps later, such as from the time it would be able to exercise its rights under nonbankruptcy law.[28]

There is no reason to believe, accordingly, that Congress intended 11 U.S.C. 506(b) to cast a shadow on 11 U.S.C. 361.[29] The common sense interpretation of 11 U.S.C. 506(b) is that it provides an oversecured creditor

---

[28] This issue is somewhat complex. The argument for such a delay rests on the delay nonbankruptcy foreclosure law would impose. If it would take a secured party additional time after the filling of the petition to foreclose on a piece of property, adequate protection, it might seem to follow, would require compensation for the costs of delay only after the expiration of that time. Because the secured creditor did not have any right to the property under nonbankruptcy law any sooner, protecting the value of its nonbankruptcy rights would not seem to require compensating it for the costs of delay until then. See In re American Mariner Industries, Inc., 734 F.2d 426, 435 n.12 (9th Cir. 1984). This analysis, however, is complicated by the fact, as the bankruptcy judge noted, 49 Bankr., at 458 n.9, that a secured creditor that receives compensation only after a built-in delay may suffer an additional delay if it is later required to foreclose on the property under nonbankruptcy law. See In re Roberts, 63 Bankr. 372, 381 (Bankr. E.D. Mich. 1986). (This issue would not arise where the debtor reinstates the loan under 11 U.S.C. 1124(2).) No circuit conflict, however, yet exists on this issue. Whether the flat rule (six months) of American Mariner is preferable to a case-by-case determination or other means of control (such as retained jurisdiction by the bankruptcy court to expedite subsequent foreclosure actions), need not be decided at this time. See Brief for the United States as Amicus Curiae in Norwest Bank Worthington and Federal Land Bank of St. Paul v. James R. Ahlers, No. 86-958 14 (May 1987).

[29] Other courts that have agreed with the Fifth Circuit's result have nonetheless agreed with amicus that there is no "negative implication to be derived from Section 506(b) which is applicable to Section 361," In re American Mariner Industries, Inc., 27 Bankr. 1004, 1009 (9th Cir. Bankr. App. 1983), rev. on other grounds, 734 F.2d 426 (9th Cir. 1984).

with its rights under its loan agreement as an automatic baseline level of support. This interpretation is not at all at odds with the idea that bankruptcy law itself (as opposed to the loan agreement) provides other, potentially overlapping, protection to secured creditors generally, when they specifically request such protection.[30]

The final part of the argument against compensating secured creditors for the costs of delay stems from the perception that such compensation requires the debtor to use, for the benefit of secured creditors, unencumbered assets that would otherwise go to general creditors. Secured creditors, the argument goes, have no right to these unencumbered assets and the concept of adequate protection should not be interpreted in a way that gives these assets to them. Otherwise, the reorganization process "benefit[s] one class of creditors at the expense of another class," 793 F.2d, at 1387. This argument, however, misperceives the relative rights of the parties. The secured creditor has a right to repossess its collateral upon a default. From the moment that the secured party would be able to repossess but for bankruptcy, the debtor is using the property at the secured creditor's expense. This use is for the benefit of the unsecured creditors, who are the beneficiaries of bankruptcy proceedings.[31] If the debtor continues to hold an asset without compensating for time value, it appropriates a portion of the asset's value for the unsecured creditors. It is as if the debtor were leasing the property and not paying rent. Requiring the debtor to provide adequate protection for the costs of delay does not bring a transfer of wealth from the general creditors to secured creditors relative to the non-bankruptcy baseline. Assets are being transferred to the secured creditor only in exchange for the use of the asset.

---

[30] Thus, amicus suggests, the Ninth Circuit was wrong in using 11 U.S.C. 506(b) to limit secured creditor that ask for adequate protection to the lesser of contract interest and market-based compensation. In re American Mariner Industries, Inc., 734 F.2d 426, 432 n.12 (9th Cir. 1984).

[31] The Fifth Circuit, in its en banc opinion, suggested that secured creditors were in fact possible beneficiaries of bankruptcy reorganisation, because "its secured claim is valued on a going-concern basis in connection with a plan of reorganisation, and the secured creditor is not compelled to liquidate its collateral at forced-sale prices," 808 F.2d., at 373. This argument, however, is wrong in any case that matters for purposes of adequate protection. To be sure, if a secured creditor's contract is reinstated pursuant to 11 U.S.C. 1124(2), it might be said to be a "beneficiary" of the bankruptcy process. But in those cases, as amicus has shown, supra pp. 20-21, the secured creditor's rights during bankruptcy are measured by its contract rights, not by 11 U.S.C. 361. In cases in which reinstatement does not occur -- and hence the scope of adequate protection matters -- the Fifth Circuit's statement is wrong. In those cases, a secured creditor's rights after bankruptcy are measured by the liquidation-based value of the collateral, under 11 U.S.C. 1129(b). For purposes of construing the adequate protection provisions of 11

CONCLUSION

Amicus urges this Court to read 11 U.S.C. 361 and 362(d) as they are written and protect the "value" of United Savings' "interest" in Timbers' property: Its right to take that property upon default, sell it, and reinvest the proceeds. This requires providing United Savings with protection for the lost time value of money during the pendency of a bankruptcy case as part of its adequate protection package, subject only to the possibility of reinstatement. Thus, on this issue, the action of the Fifth Circuit should be reversed and the case remanded for further consideration consistent with the reversal.

Respectfully submitted,

Thomas H. Jackson
Amicus Curiae, pro se
Harvard Law School
Cambridge, MA 02138

(617) 495-3183

July, 1987

(continued)
U.S.C. 361, accordingly, it is incorrect to say that secured creditors are "beneficiaries" of the reorganization process. See also supra note 13 (secured creditors that receive adequate protection should not also be entitled to increases in the value of collateral that occur during bankruptcy).

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
FILED
AUG 3 1987
JOSEPH F. SPANIOL, JR.
CLERK

(7)

No. 86-1602

IN THE
Supreme Court of the United States
OCTOBER TERM, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,
v.
TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

---

BRIEF OF CALIFORNIA LEAGUE OF SAVINGS INSTITUTIONS, AMERICAN BANKERS ASSOCIATION, AND CALIFORNIA BANKERS ASSOCIATION AS AMICI CURIAE IN SUPPORT OF PETITIONER

JOHN A. GRAHAM
Counsel of Record
LESLEY ANNE HAWES
FRANDZEL & SHARE
A Law Corporation
8383 Wilshire Boulevard
Suite 400
Beverly Hills, California 90211
(213) 852-1000
Attorneys for Amici Curiae California League of Savings Institutions, American Bankers Association, and California Bankers Association

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

TABLE OF CONTENTS

Page

INTEREST OF THE AMICI CURIAE 1

A. Nature of the Organizations 2

B. Effect of the Decision on the Lending Industry.... 3

SUMMARY OF ARGUMENT 4

ARGUMENT 6

I. *TIMBERS* PLACES THE UNDERSECURED CREDITOR IN A LEGAL TWILIGHT ZONE WITH NO MEANS OF REDRESS FOR THE IMPAIRMENT OF ITS INTEREST IN PROPERTY 6

A. A Landlord Is Entitled to Be Compensated for the Use of Its Property 8

B. The Automatic Stay Becomes an Irrevocable License for the Debtor to Use the Undersecured Creditor's Collateral Without Payment 8

C. The Prejudice to a Secured Creditor Cannot Be Mitigated by a Motion to Convert or Dismiss the Proceeding 9

D. *Timbers* Precludes an Undersecured Creditor from Realizing the True Value of Its Bargained-for Rights 11

E. An Undersecured Creditor Has an Interest in Property, Not Merely a Claim 11

II. THE *TIMBERS* RESULT UNDERMINES THE POLICY OF PROMOTING THE ASSISTANCE OF FINANCIALLY TROUBLED BORROWERS 12

A. The Decision Creates a Substantial Disincentive for Lenders to Advance Additional Funds to an Obligor to Avoid Bankruptcy.... 12

B. The Decision Creates an Incentive to Require More Collateral for Secured Loans 15

TABLE OF CONTENTS—Continued

Page

III. ADEQUATE PROTECTION OF THE PRESENT VALUE OF THE CREDITOR'S RIGHT TO LIQUIDATE ITS COLLATERAL IS CONSISTENT WITH THE LEGISLATIVE HISTORY OF SECTION 361 16

  A. The Concept of Adequate Protection Was Broadly Defined to Encompass More Than Just Those Property Rights Protected by the Constitution 16

  B. *Timbers* Improperly Limits the Interests Protected by Section 361 to Rights That Cannot Be Impaired Under the Constitution.. 19

IV. THE OUTER LIMITS OF *TIMBERS* ARE UNKNOWN 23

CONCLUSION 25

TABLE OF AUTHORITIES

Page

UNITED STATES SUPREME COURT

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) 16, 19, 21, 21-22, 22

Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940) 19

Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke, 300 U.S. 440 (1937) 20, 23

CIRCUIT COURTS OF APPEALS

In re Briggs Transportation Company, 780 F.2d 1339 (8th Cir. 1985) 10

In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935) 18

In re Timbers of Inwood Forest Associates, Ltd., 808 F.2d 363 (5th Cir. 1987) (en banc) 1, 5, 9, 11

In re Timbers of Inwood Forest Associates, Ltd., 793 F.2d 1380 (5th Cir. 1986) (panel opinion) .. *passim*

Sunshine State Bank v. Federal Deposit Ins. Corp., 783 F.2d 1580 (11th Cir. 1986) 14

DISTRICT COURTS

Com. of Pa. State Emp. Retirement Fund v. Roane, 14 Bankr. 542 (E.D. Pa. 1981) 24

In re Carson, 34 Bankr. 502 (D. Kan. 1983) 13

Matter of Blazon Flexible Flyer, Inc., 407 F. Supp. 861 (N.D. Ohio 1976) 24

BANKRUPTCY COURTS

In re AAA Produce Co., Inc., 58 Bankr. 430 (Bankr. E.D. Mo. 1986) 13

In re Advisory Information and Management Systems, Inc., 50 Bankr. 627 (Bankr. M.D. Tenn. 1985) 9

In re Breuer, 4 Bankr. 499 (Bankr. S.D.N.Y. 1980) 24

In re Cooper Properties Liquidating Trust, 61 Bankr. 531 (Bankr. W.D. Tenn. 1986) 10

TABLE OF AUTHORITIES—Continued

	Page
In re Grant, 29 Bankr. 375 (Bankr. M.D. Pa. 1983)	13, 25
In re LeMay, 18 Bankr. 659 (Bankr. D. Mass. 1982)	13, 25
In re Powell Bros. Ice Co., 37 Bankr. 104 (Bankr. D. Kan. 1984)	10
In re Rogers Dev. Corp., 2 Bankr. 679 (Bankr. E.D. Va. 1980)	24
In re Sheehan, 58 Bankr. 296 (Bankr. D.S.D. 1986)	10
In re Shockley Forest Industries, Inc., 5 Bankr. 160 (Bankr. N.D. Ga. 1980)	24
Matter of Provincetown-Boston Airline, Inc., 66 Bankr. 632 (Bankr. M.D. Fla. 1986)	9
Matter of Stratbucker, 4 Bankr. 251 (Bankr. D. Neb. 1980)	13

UNITED STATES STATUTES

11 U.S.C. § 361	7, 20, 23, 24
11 U.S.C. § 361(3)	9, 17
11 U.S.C. § 362(d)(1)	4
11 U.S.C. § 364	13
11 U.S.C. § 365(d)(2)	8
11 U.S.C. § 365(d)(3)	8
11 U.S.C. § 503(b)(1)(A)	9
11 U.S.C. § 506	23
11 U.S.C. § 1112	9
11 U.S.C. § 1112(b)	9-10, 10

LEGISLATIVE MATERIALS

S. 2266, 95th Cong., 2d Sess. § 361 (1978), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. VII (15th ed. 1987)	16
S. 2266, 95th Cong., 2d Sess. § 1129 (1978), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. VII (15th ed. 1987)	18
H.R. 8200, 95th Cong., 1st Sess. § 361 (1977), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. III (15th ed. 1987)	16, 17

TABLE OF AUTHORITIES—Continued

	Page
H.R. 8200, 95th Cong., 1st Sess. § 1129 (1977), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. III (15th ed. 1987)	18
S. REP. No. 989, 95th Cong., 2d Sess. (1978), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. V (15th ed. 1987)	18-19, 19
H.R. REP. No. 595, 95th Cong., 1st Sess. (1977), *reprinted in* App. 2 COLLIER ON BANKRUPTCY ch. II (15th ed. 1987)	17, 19
124 CONG. REC. 11,092 (1978) (statement by Rep. Edwards), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. IX (15th ed. 1987)	9, 17, 18

REGULATIONS

12 C.F.R. § 545.32	15
12 C.F.R. § 561	14
12 C.F.R. § 563.17-2(d)	15

TREATISES

4 F. SOLOMON, D. HAKALA, D. AUSTIN, W. SCHLICHTING & J. COOPER, BANKING L. (1986) § 80.26[2]	14

ARTICLES AND MISCELLANEOUS AUTHORITIES

Clarke, *The Limits of Bank Regulation*, ANN. REV. BANKING L., 1987, at 227	3
Hicks, *Rural Bank Failures Aren't a Big Problem—Yet*, AM. BANKER, Aug. 28, 1986, at 4, col. 1	2
Short, *Bank Problems and Financial Safety Nets*, ECON. REV., March 1987, at 17	3
FHLBB Memorandum #R41c (Sept. 11, 1986), *reprinted in* 1 Fed. Guide (U.S. League of Savings Institutions) ¶ 9842 at 2756, May, 1987	14

In The

Supreme Court of the United States

October Term, 1987

No. 86-1602

United Savings Association of Texas,
Petitioner,
v.
Timbers of Inwood Forest Associates, Ltd.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF CALIFORNIA LEAGUE OF SAVINGS INSTITUTIONS, AMERICAN BANKERS ASSOCIATION, AND CALIFORNIA BANKERS ASSOCIATION AS AMICI CURIAE IN SUPPORT OF PETITIONER

INTEREST OF THE AMICI CURIAE

The California League of Savings Institutions, the American Bankers Association, and the California Bankers Association submit this brief as amici curiae, with the consent of the parties, to provide the Court with an analysis of the implications of the *Timbers* decision[1] from the perspective of the lending industry. The organizations submit this brief in support of the petitioner, United Savings Association of Texas, in order to highlight the practical, legal, and policy considerations that require the Court to reverse the ruling of the Fifth Circuit in this case.

---

[1] *In re Timbers of Inwood Forest Associates, Ltd.*, 793 F.2d 1380 (5th Cir. 1986) (panel opinion), *aff'd on rehearing*, 808 F.2d 363 (5th Cir. 1987) (en banc). Since the *en banc* opinion reinstates

A. Nature of the Organizations

The California League of Savings Institutions ("Cal League") is an association organized to advance the interests of more than 200 savings and loan associations and savings banks whose principal place of business is in the state of California. The members of this organization include eight of the nation's ten largest savings institutions. The constituents of the Cal League collectively hold total assets in excess of $310 billion, representing over 25% of all assets held by savings and loan associations nationwide. As of December 31, 1986, $183.5 billion of those assets represented mortgage loans secured by real property. The Cal League also has the dubious distinction of representing lenders in a state that has suffered 24 thrift institution failures in the last five years. *See* Hicks, *Rural Bank Failures Aren't a Big Problem—Yet*, AM. BANKER, Aug. 28, 1986, at 4, col. 1.

The American Bankers Association ("ABA") is the principal trade association of the commercial banking industry in the United States. There are member banks of the ABA located in each of the fifty states and the District of Columbia, including banks chartered by the Comptroller of the Currency (National Banks) and banks chartered by the states in which they are located (State Banks). The banking industry has also suffered a significant increase in the number of failed or problem institutions.[2] The Comptroller of the Currency has cited deteriorating asset quality as a key factor in the decline in bank earnings in recent years. *See* Clarke, *The Limits of Bank Regulation*, ANN. REV. BANKING L., 1987, at 227, 230.

The California Bankers Association ("CBA") is the statewide association for the commercial banking industry in California, representing both national and state banking organizations. The CBA's membership includes almost all the more than 450 commercial banks doing business in the state. The institutions represented by the CBA have assets totalling more than $242 billion.

B. Effect of the Decision on the Lending Industry

The Fifth Circuit's decision in this case radically alters the rights and remedies of a secured creditor by redefining the secured creditor's "interest" in its collateral and the extent to which that interest is entitled to "adequate protection" during a Chapter 11 proceeding. By rejecting the rule of the Fourth and Ninth Circuits that an undersecured creditor is entitled to have the present value of its interest in collateral adequately protected, the Fifth Circuit's ruling compels the undersecured creditor to contribute its collateral to the debtor and the estate indefinitely, without compensation, denying the undersecured creditor protections granted to other similarly situated entities with equivalent interests in property.

The *Timbers* decision takes a narrow, unrealistic approach to the secured creditor's property interest. The decision ignores an essential element of that interest—time—and the concept upon which the entire lending industry is founded: the time value of money.

---

the panel opinion, all textual references hereinafter to "*Timbers*" pertain to the panel opinion unless otherwise noted.

[2] The percent of banks listed as "problem" institutions has jumped from approximately 2% in 1982 to approximately 10% in 1986, with almost 1500 institutions across the country listed in this category. Short, *Bank Problems and Financial Safety Nets*, ECON. REV., March 1987, at 17.

Timbers precludes the bankruptcy court from striking a balance between the debtor's interest in reorganizing and the creditor's interest in stemming the continuing financial losses it incurs while it is stayed from liquidating its collateral. The decision creates substantial disincentives for lenders to assist financially troubled borrowers and thereby undermines the very policy of financial rehabilitation the Bankruptcy Code was intended to promote. The amici curiae support the position advocated by petitioner because of the deleterious consequences of the *Timbers* ruling and the errors of the Fifth Circuit's analysis.

SUMMARY OF ARGUMENT

The Fifth Circuit in *Timbers* holds that an undersecured creditor whose collateral is not depreciating is not entitled to relief from the automatic stay under 11 U.S.C. Section 362(d)(1)[3] for lack of adequate protection, even though the debtor is making no payments to the creditor on the debt and the creditor would otherwise have the immediate right to liquidate the collateral and relend or reinvest the proceeds. Collateral with a market price of $100,000 today may still have a market price of $100,000 in two years. However, an undersecured creditor's right to obtain $100,000 in cash today through the liquidation of the property is worth much more than the right to obtain $100,000 in two years because of the income that could have been earned from those funds. The difference in the value of these two rights is a loss in the value of the undersecured creditor's property interest. This loss is acknowledged by *Timbers* yet held not to be protected under the Bankruptcy Code.

By definition, an undersecured creditor's interest in the property securing its loan is all-encompassing. Absent the bankruptcy, an undersecured creditor would be entitled to assume control over and sell the property, realizing for its own interests all the benefits that an owner of the property would obtain. The debtor's interest in the property is in effect bare title unless and until the creditor's debt is satisfied. For all practical purposes, an undersecured creditor has a property interest equivalent to that of an owner except that, unlike an owner, an undersecured creditor's primary goal is to convert its property interest into cash.

An owner of property, such as a landlord, may be compelled to permit the debtor to continue to use its property during a reorganization proceeding. The *Timbers* ruling imposes the same burden on an undersecured creditor. The difference, however, between the rights of an undersecured creditor under *Timbers* and an owner is that an owner is still entitled to periodic compensation for the economic benefit it confers on the debtor and the estate while an undersecured creditor is entitled to nothing: no payment on the debt, no payment for the economic value the debtor receives by retaining the property, and no compensation for what amounts to a forced loan of the cash the creditor could have reinvested.

The Fifth Circuit's "solution" to this dilemma is that the undersecured creditor move for conversion or dismissal of the case under 11 U.S.C. Section 1112. *Timbers*, 808 F.2d at 371-72. Section 1112 was not designed to be an effective mechanism for a secured creditor to protect its rights during a reorganization proceeding and cannot accommodate the interests of an individual undersecured creditor whose rights are being prejudiced. The provisions governing adequate protection, the right to relief from the automatic stay, and the debtor's right to use property in which another party has an interest were so designed and were broadly drafted to encompass protection for delay in the creditor's right to enforce its interest in its collateral.

---

[3] Hereinafter, all statutory references are to Title 11 of the UNITED STATES CODE (Bankruptcy Code) unless otherwise noted.

The legislative history of the adequate protection provisions of the Bankruptcy Code recognizes the tangible and quantifiable damage a secured creditor suffers from the delay in converting its collateral into cash and expresses a policy that the value of that interest in property be protected so that a secured creditor can realize the "indubitable equivalent" of the value of its bargained-for rights. Although a secured creditor's "bargain in kind," that is, the right to proceed with its foreclosure, may be stayed, the "value" of the creditor's bargain—the right to convert the collateral to cash—is required to be preserved. The *Timbers* decision utterly fails to recognize or preserve that value.

ARGUMENT

I. *TIMBERS* PLACES THE UNDERSECURED CREDITOR IN A LEGAL TWILIGHT ZONE WITH NO MEANS OF REDRESS FOR THE IMPAIRMENT OF ITS INTEREST IN PROPERTY.

The *Timbers* decision transforms a Chapter 11 proceeding into a vortex for an undersecured creditor by eliminating the only means available to protect the value of the creditor's right to realize on its collateral. As long as the market price of the property securing the loan remains stable, the *Timbers* decision deems the undersecured creditor adequately protected as a matter of law, preventing the creditor from obtaining relief from the automatic stay under Section 362 or compensation as a condition to the debtor's continued retention and use of its collateral under Section 363. *See Timbers*, 793 F.2d at 1416. In contrast, an oversecured creditor continues to accrue interest on its debt and may be entitled to adequate protection payments to maintain any existing equity cushion in the property, and an owner of property is entitled to periodic payments for the reasonable value of the use of its property. The undersecured creditor alone is required to sacrifice its property rights, without compensation, for the benefit of the debtor and the general unsecured creditors.

The Fifth Circuit equates the secured creditor's "interest in property" with its "allowed secured claim" for the purpose of adequate protection under Section 361 and concludes that if the property securing the loan has a stable market price, the "value" of the secured claim is unchanged and "adequately protected." *Timbers*, 793 F.2d at 1385, 1400. This analysis ignores the unique interest the debtor conveys to a lender when it obtains a secured loan—an interest in property that entitles the creditor to promptly satisfy its debt out of the collateral.

The creditor's allowed secured claim under *Timbers* is given no more protection than the claims of general unsecured creditors. Just as the filing of the petition creates a general fund that will be devoted to the claims of unsecured creditors at an indeterminate time in the future, the secured creditor's collateral becomes nothing more than a specific fund out of which the secured creditor's claim will be paid at some indefinite future date, generally when the Chapter 11 proceeding fails.

The quagmire in which the *Timbers* decision places an undersecured creditor may be illustrated in the hypothetical reorganization of a large, multi-faceted corporation, the XYZ Company.[4] The XYZ Company manufactures and sells widgets, employs hundreds of workers, and owns and leases a number of different physical facilities, including two similar warehouses. An undersecured creditor in this hypothetical Chapter 11 proceeding has a security interest in one such facility, Warehouse A, which has a market price of $1,000,000 at the inception of the case. The fair market value of the warehouse is expected to remain stable for the next several years. At the time of the Chapter 11 petition, the XYZ Company owes $1,200,000 to the creditor. Warehouse B is owned by a landlord and is rented to the debtor under a long-term lease that will not expire for several years.

---

[4] Recent large reorganization proceedings, including the Wickes Corporation, Storage Technology Corporation, Continental Airlines, Braniff Airways, and Wheeling Pittsburgh Steel Corporation, provide real-world examples of cases in which this hypothetical scenario is likely to occur. Although the effect of the *Timbers* ruling on an undersecured creditor in a major reorganization is more dramatic because the delay involved may run well in excess of 2 years, as did the delays in these cases, the problems raised by *Timbers* are present in almost any reorganization involving more than a single asset or a few creditors.

The debtor is occupying both warehouses and needs both facilities to store its product for sale. Both warehouse facilities are necessary to the debtor's reorganization effort. Even if other similar facilities could be located, the delay, moving expenses, and disruption that would occur if the debtor were forced to vacate the facilities would hamper its effort to reorganize.

A. A Landlord Is Entitled to Be Compensated for the Use of Its Property.

The owner of Warehouse B can require the debtor to continue to perform its obligations under the lease, including its rental payment obligation, until the debtor assumes or rejects the lease. 11 U.S.C. § 365(d)(3). The assumption or rejection may occur at any time up to the date of the confirmation of the plan. 11 U.S.C. § 365(d)(2). The owner/lessor's right to receive payments during the bankruptcy as compensation for the economic value of the use of the property exists notwithstanding its right to assert an administrative claim under Section 503(b). 11 U.S.C. § 365(d)(3).

B. The Automatic Stay Becomes an Irrevocable License for the Debtor to Use the Undersecured Creditor's Collateral Without Payment.

Since Warehouse A has a stable value, the undersecured creditor would be considered "adequately protected" as a matter of law under *Timbers*. The creditor

would not be entitled to relief from the automatic stay or to condition the debtor's right to retain the property on its providing periodic payments or some other form of adequate protection. The debtor under *Timbers* would therefore have the absolute and unconditional right to use the undersecured creditor's collateral indefinitely without charge during the pendency of the case.[5]

C. The Prejudice to a Secured Creditor Cannot Be Mitigated by a Motion to Convert or Dismiss the Proceeding.

The Fifth Circuit in *Timbers* suggests that the mechanism by which the undersecured creditor should protect its interests is a motion to dismiss or convert the case under 11 U.S.C. Section 1112. *Timbers*, 808 F.2d at 371-72. In the hypothetical set forth above, such a motion would be doomed to fail absent a substantial passage of time or the support of key constituent creditor groups.

Section 1112 requires the court to evaluate "the best interests of creditors and the estate" to determine whether a case should be dismissed or converted "for cause." 11 U.S.C. § 1112(b). Cause may be demonstrated by "continuing loss to or diminution of the estate," and the debtor's inability to effectuate a plan or unreasonable delay in confirming a plan. 11 U.S.C. § 1112(b). A survey of decisions involving motions to convert or dismiss Chapter 11 proceedings reveals a proper reluctance by the courts to cut short a debtor's good faith attempt at rehabilitation on the motion of a single creditor or faction of creditors unless the debtor has demonstrated a total inability or lack of effort to effectively reorganize. *See, e.g., In re Sheehan*, 58 Bankr. 296 (Bankr. D.S.D. 1986) (in which the court also rejected the movant undersecured creditor's claim that it was not adequately protected because of the delay in enforcing its rights, relying on *In re Briggs Transportation Company*, 780 F.2d 1339 (8th Cir. 1985)); *In re Cooper Properties Liquidating Trust*, 61 Bankr. 531 (Bankr. W.D. Tenn. 1986); *In re Powell Bros. Ice Co.*, 37 Bankr. 104 (Bankr. D. Kan. 1984) (in which the court similarly rejected the moving undersecured creditors' contention that their rights were prejudiced by delay on the rationale that their claims were not allowed to accrue interest under the Code in any event).

---

[5] The possibility of an undersecured creditor's asserting an administrative claim under Section 503(b)(1)(A) theoretically exists. However, Congress expressly *rejected* the concept that an administrative claim constitutes adequate protection because of the risk that the estate will have insufficient assets to pay those claims. *See* 124 CONG. REC. 11,092 (1978) (statement of Rep. Edwards), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. IX (15th ed. 1987) (hereinafter "124 CONG. REC. 11,092 (1978)"). Further, some courts have interpreted Section 361(3) and its legislative history as precluding a secured creditor from asserting an administrative claim on the ground that the creditor's proper remedy is to seek adequate protection. *See, e.g., Matter of Provincetown-Boston Airline, Inc.*, 66 Bankr. 632 (Bankr. M.D. Fla. 1986); *In re Advisory Information and Management Systems, Inc.*, 50 Bankr. 627 (Bankr. M.D. Tenn. 1985).

Based upon the policies and purposes of the Code and the cases construing Section 1112(b), it is unlikely that the proceeding in this hypothetical would be dismissed or converted for years, *particularly on the motion of an undersecured creditor who is deemed to be adequately protected. See Sheehan*, 58 Bankr. at 296; *Powell Bros.*, 37 Bankr. at 104. The solution offered by the *Timbers* court is not a remedy for the ills of individual undersecured creditors when general unsecured creditors are entitled to the opportunity to try to maximize their recovery through the reorganization process.

D. *Timbers* Precludes an Undersecured Creditor from Realizing the True Value of Its Bargained-for Rights.

In the scenario set forth above, if the reorganization were to fail after two years,[6] and the creditor could have reinvested the proceeds of its collateral at a 12% interest rate, compounded monthly, the creditor would have earned $269,734 during the time it was deprived of the right to foreclose. Using a 12% discount rate, compounded monthly, the $1,000,000 value of the property, which the creditor would have realized at the time the bankruptcy was filed, would have been reduced by over 20% to a present value of only $787,566.13 at the termination of the case. That the market price of collateral is stable *does not* mean that a creditor "realizes" the same "value" of its interest in property whether it forecloses today or in two years.

E. An Undersecured Creditor Has an Interest in Property, Not Merely a Claim.

Although the general unsecured creditors of the estate may suffer a loss in realizing the present value of their claims, the secured creditor has more than just a claim. In granting a security interest, the debtor voluntarily transfers a specific interest in its property to the creditor in order to provide the creditor a means to ensure prompt repayment of the debt in the event of default. This interest in property distinguishes the "allowed secured claim" of a secured creditor from the claim of a general creditor of the estate.

---

[6] Statistics compiled by the Administrative Office of the United States Courts indicate that over 90% of Chapter 11 cases are ultimately either dismissed without a Chapter 11 plan or converted to Chapter 7. *See Timbers*, 808 F.2d at 382 (Jones, J., dissenting). The astounding failure rate of Chapter 11 proceedings only confirms the devastating impact of the *Timbers* decision. Statistically, the damage the undersecured creditor suffers from the delay will not have the intended result of assisting the reorganization since no reorganization will occur.

The *Timbers* decision relegates the treatment of an undersecured creditor's allowed secured claim to that of a general unsecured claim. The decision permits the present value of an allowed secured claim to deteriorate over the course of the Chapter 11 proceeding and allows the debtor to control the timing of the satisfaction of the secured creditor's lien. The "interest in property," which differentiates the rights of a secured creditor from those of a general claimant, is rendered meaningless by such treatment.

II. THE *TIMBERS* RESULT UNDERMINES THE POLICY OF PROMOTING THE ASSISTANCE OF FINANCIALLY TROUBLED BORROWERS.

Under *Timbers*, any accommodation made by the lender to work out its debt with a borrower may imperil the lender's interests if a bankruptcy is ultimately filed. In relieving the debtor of the burden of adequately protecting the present value of the secured creditor's property interest, the Fifth Circuit's decision may have detrimental ramifications on the relationship of debtors and lenders outside bankruptcy.

A. The Decision Creates a Substantial Disincentive for Lenders to Advance Additional Funds to an Obligor to Avoid Bankruptcy.

The *Timbers* decision materially increases the risk to a secured creditor in providing additional funds to an obligor without also obtaining additional collateral. Providing an additional advance secured by the same collateral increases the risk of a creditor's becoming undersecured and thereafter becoming mired in a protracted Chapter 11 proceeding without any hope of realizing the true present value of its security.

A secured creditor might, for example, hold a $5 million lien on property worth $6 million. The debtor may be experiencing a temporary but serious cash flow shortage and may request an additional $1 million advance, to be secured by the same collateral, and a deferral of payments on the debt until the debtor's cash crisis subsides. The debtor may be able to provide the creditor with projections that demonstrate the long-term viability of the enterprise and the debtor's ability to recover from its immediate financial difficulties.

If the secured creditor does not lend the additional funds in this circumstance, and the debtor files bankruptcy, the secured creditor will be compensated for any delay in recovering its collateral through accruing interest and, if the equity cushion is eroding too quickly, through adequate protection to maintain the creditor's interest in the property. *See, e.g., In re Grant*, 29 Bankr. 375 (Bankr. M.D. Pa. 1983); *In re Carson*, 34 Bankr. 502 (D. Kan. 1983); *In re LeMay*, 18 Bankr. 659 (Bankr. D. Mass. 1982). Further, if the lender extends the additional credit to the obligor post-petition, the protections of Section 364 will apply, permitting the creditor to accrue interest on the additional advance as well as on the original loan. *See In re AAA Produce Co., Inc.*, 58 Bankr. 430 (Bankr. E.D. Mo. 1986); *Matter of Stratbucker*, 4 Bankr. 251 (Bankr. D. Neb. 1980).

The *Timbers* decision would create a substantially greater risk for the creditor if it were to extend the additional credit in an effort to prevent the obligor's bankruptcy. Granting the additional advance may place the creditor in the *Timbers* pitfall of being deemed "adequately protected." To make the advance would only expose the creditor to the risk of indefinite delay in the realization of the value of its collateral without any hope of recovering its lost opportunity costs on the original loan, much less the subsequent advance. Under *Timbers*, there is virtually no advantage or incentive for the creditor to make such an advance.

The peril to a creditor's rights under *Timbers* and the anomaly of the *Timbers* view of the "value" of a creditor's interest in property is confirmed for financial institutions by the accounting effects of the *Timbers* result. For example, financial institutions subject to Federal Home Loan Bank Board ("FHLBB") regulation are required to obtain appraisals of collateral that include a "discount to present value" analysis of the property securing their loans. *See* FHLBB Memorandum #R41c (Sept. 11, 1986), *reprinted in* 1 Fed. Guide (U.S. League of Savings Institutions) ¶ 9842 at 2756, May, 1987) (the FHLBB is in the process of enacting a form of this memorandum as a federal regulation in light of certain due process questions that have recently been raised) (hereinafter "Memorandum R41c").[7] Paragraph 9 of Memorandum R41c defines "market value" of the collateral and specifically states: "Implicit in this definition is the consummation of a sale as of a specified date . . . ." Memorandum R41c, at 2757.

For a secured creditor confronted with a *Timbers* situation, the value of its collateral is not, as *Timbers* suggests, the market price the property may be sold for in the future. Rather, under the Memorandum R41c guidelines the value is the market price the creditor can achieve whenever the sale is allowed to proceed, *reduced by an applicable discount rate for the time the creditor is expected to have to wait before that amount is received.* The difference between the outstanding debt on the lender's books and the *discounted value* of the collateral may constitute an immediate loss against which the institution must reserve and which may be charged against its current earnings. *See, e.g.*, 12 C.F.R. § 563.17-2(d). The creditor clearly does not realize the indubitable equivalent of the present market value of the collateral when its foreclosure is substantially delayed. The diminishment of the value of the creditor's interest in the property is tangibly reflected in the adjustments to its books that may be required in any case in which the *Timbers* rule applies.

B. The Decision Creates an Incentive to Require More Collateral for Secured Loans.

The effect of the *Timbers* decision is to harshly penalize the lender whose collateral is insufficient to satisfy its debt by compelling the lender to donate the economic value of the collateral to the estate in a Chapter 11 proceeding indefinitely, without payment, and without any means of recovering the losses suffered while the lender is unable to liquidate the collateral and relend or reinvest the proceeds in a new, income-generating asset. This severe penalty may prompt lenders to require collateral valued substantially in excess of the debt to support a potential lengthy delay through the bankruptcy process or a change in the market value of the property.

The regulations governing financial institutions include specific requirements for the loan-to-value ratio that must exist in a secured lending transaction. *See, e.g.*, 12 C.F.R. §§ 545.32 *et seq.* These loan-to-value ratios are designed, among other things, to provide the creditor with enough additional value in the collateral to avoid a loss during the time delays before the debt can be satisfied by a sale of the property. Under *Timbers*, those anticipated time delays are extended far beyond the ordinary four- to six-month time frame traditionally experienced by creditors outside bankruptcy. The most readily available means for the creditor to protect against the risk of this kind of loss is to insist on greater collateral values for loans, chilling the ability of borrowers to obtain reasonable credit facilities.[8]

---

[7] Although this memorandum was issued in 1986, the position set forth in the memorandum on the valuation of collateral reflects a long-standing policy of the FHLBB. *See* Memorandum R41c Synopsis. A financial institution's assets and the collateral securing its loans have traditionally been evaluated by the regulatory authorities based upon significant events impacting the manner and timing of recovery. *See, e.g., Sunshine State Bank v. Federal Deposit Ins. Corp.*, 783 F.2d 1580 (11th Cir. 1986); 4 F. SOLOMON, D. HAKALA, D. AUSTIN, W. SCHLICHTING & J. COOPER, BANKING L. §§ 80.26[2] *et seq.*; 12 C.F.R. §§ 561 *et seq.*

III. ADEQUATE PROTECTION OF THE PRESENT VALUE OF THE CREDITOR'S RIGHT TO LIQUIDATE ITS COLLATERAL IS CONSISTENT WITH THE LEGISLATIVE HISTORY OF SECTION 361.

The Fifth Circuit relies on the absence of specific congressional pronouncements requiring adequate protection for lost opportunity costs incurred by the secured creditor to support the conclusion that the Code prohibits protection of that interest in property. *Timbers*, 793 F.2d at 1382, 1402. To arrive at this inference, the court trivializes the addition of the indubitable equivalent standard to Section 361 and ignores the legislative statement that the concept of adequate protection is intended to protect the property interests that embody the benefit of the creditor's bargain, even if those interests are not subject to strict constitutional protection. The result in *Timbers* violates the policies and purposes of Section 361 as expressed in these critical aspects of the legislative history.

A. The Concept of Adequate Protection Was Broadly Defined to Encompass More Than Just Those Property Rights Protected by the Constitution.

The House and the Senate each passed versions of what ultimately became the Bankruptcy Code of 1978. *See* H.R. 8200, 95th Cong., 1st Sess. § 361 (1977); S. 2266, 95th Cong., 2d Sess. § 361 (1978), both *reprinted in* App. 3 Collier on Bankruptcy chs. III and VII respectively (15th ed. 1987). Section 361 of the Senate bill

---

[8] The effect of this type of ruling on the availability of credit was specifically noted in *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935), one of the cases cited by Congress as the source for the concept of adequate protection. *See infra* Part IIIB, and *Radford*, 295 U.S. 555, 595 n.27.

included only two subdivisions.[9] The House bill, however, added two additional subdivisions which provided for the granting of an administrative claim to compensate for the decrease in the value of the entity's interest in the property,[10] and the "granting of such other relief as will result *in the realization by such entity of the value of such entity's interest in such property.*" (Emphasis added.) H.R. 8200, 95th Cong., 1st Sess. § 361 (1977), *reprinted in* App. 3 Collier on Bankruptcy ch. III (15th ed. 1987).

The purpose of subdivision (4) of Section 361 proposed by the House was described in the House Report accompanying H.R. 8200. The Report states:

> *The paragraph also defines, more clearly than the others, the general concept of adequate protection, by requiring such relief as will result in the realization of value.* It is the general category, and as such, *is defined by the concept involved* rather than any particular method of adequate protection. [Emphasis added.]

H.R. Rep. No. 595, 95th Cong., 1st Sess., 340 (1977), *reprinted in* App. 2 Collier on Bankruptcy ch. II (15th ed. 1987) (hereinafter "H.R. Rep.").

The language of Section 1129 proposed by the Senate included the term "indubitable equivalent" in the context of the "cram-down" provisions relating to the confirmation of a plan. S. 2266, 95th Cong., 2d Sess. § 1129 (1978), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. VII (15th ed. 1987). The House bill did not contain this language in its proposed Section 1129. *See* H.R. 8200, 95th Cong., 1st Sess. § 1129 (1977), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. III (15th ed. 1987). In Section 361 of the final version of the legislation, the phrase "indubitable equivalent" was retained in Section 1129 and *added* to the adequate protection provision. Comments by Representative Edwards analyzing the modification to Section 361 specifically refer to the addition of the term "indubitable equivalent" and set forth an example of the operation of the indubitable equivalent standard in certain secured transactions:

---

[9] The two provisions were identical to the House version of the legislation and were ultimately enacted without modification as current Sections 361(1) and 361(2).

[10] The Senate criticized the provision granting an administrative expense on the ground that there was too much uncertainty as to whether sufficient assets would be available at the end of the case to satisfy the claim. *See* 124 Cong. Rec. 11,092 (1978). Congress eliminated that paragraph and expressly excluded the granting of an administrative claim as a means of providing adequate protection at the same time that it added the indubitable equivalent standard to the final version of Section 361. *See* 11 U.S.C. § 361(3).

> Section 361(4) of H.R. 8200 as passed by the House is modified in section 361(3) of the House amendment to indicate that the court may grant other forms of adequate protection, other than an administrative expense, *which will result in the realization by the secured creditor of the indubitable equivalent of the creditor's interest in property.* In the special instance where there is a reserve fund maintained under the security agreement, such as in the typical bondholder case, *indubitable equivalent means that the bondholders would be entitled to be protected as to the reserve fund, in addition to the regular payments needed to service the debt.* [Emphasis added.]

124 CONG. REC. 11,092 (1978).

There should be no doubt as to the significance of the term "indubitable equivalent" and its derivation since Congress specifically referred to the present-value concept set forth by Judge Learned Hand in *In re Murel Holding Corp.*, 75 F.2d 941 (2d Cir. 1935).[11] *See* S. REP.

---

[11] Although the *Murel Holding Corp.* decision is viewed as a case involving plan confirmation, the procedural context in which the decision arose was a motion by the creditor to *vacate the injunction* obtained by the debtor staying the creditor's enforcement of

No. 989, 95th Cong., 2d Sess., 127 (1978), *reprinted in* App. 3 COLLIER ON BANKRUPTCY ch. V (15th ed. 1987) (hereinafter "S. REP."). The example provided by Congress to illustrate the operation of this standard indicates an intent by Congress to preserve the benefit of the secured creditor's bargain in bankruptcy. If that value were not intended to be preserved, there would be no need to require protection both for the reserve fund and for the regular payments on the debt.

B. *Timbers* Improperly Limits the Interests Protected by Section 361 to Rights That Cannot Be Impaired Under the Constitution.

Perhaps the most substantial support for the protection of the present value of a secured creditor's interest in property is found in the cases cited by both the House and the Senate as the source of the concept of adequate protection. The Senate Report states: "The concept of adequate protection is derived from the fifth amendment protection of property interests as enunciated by the Supreme Court. *See Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940); *Louisville Joint Stock Land Bank v. Radford*, 295 U.S. 555 (1935)." S. REP. at 49. The House Report contains a similar statement, cites the same cases, and adds: "*It is not intended to be confined strictly to the constitutional protection required, however. The section, and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. Secured creditors should not be deprived of the benefit of their bargain.*" (Emphasis added.) H.R. REP. at 339. Although the erosion of the present value of the secured

---

its mortgage on the ground that the plan proposing to defer payment of the mortgage for ten years did not adequately protect the creditor's interest in the property. The court agreed, suggesting indubitable equivalence as the standard by which the adequate protection of the mortgagee's interest in the property must be governed, and ordered that the injunction be vacated.

creditor's interest in property may not in all instances rise to the level of an unconstitutional taking of property, the legislative reference to the *Union Central* and *Radford* decisions as the source for the *principles* underlying the concept of adequate protection offers substantial support for the proposition that adequate protection was designed to preserve more than just the fair market value of the collateral.

In *Radford*, this Court held that the Frazier-Lemke Act unconstitutionally impaired existing mortgagees' property rights by stripping away the essential attributes of the mortgagees' interest in collateral without due process.[12] However, the significance of the *Radford* decision to the concept of adequate protection under the Bankruptcy Code lies not in the constitutional question decided in the case. The legislative comments cited above state that the protections of Section 361 were *not* designed to extend only as far as the constitutionally guaranteed property rights of the secured creditor. To the contrary, the comments in the House Report suggest that it is the policies and principles set forth in these decisions that Congress relied upon in developing the adequate protection concept and in determining that adequate protection should protect more than merely the property interests that cannot be impaired under the Constitution.

The injury upon which the Court focused its attention in *Radford* was not the potential decline in the market value of the property but rather the diminishment of the economic value realized by the mortgagee based on the time delay in obtaining the proceeds of its collateral.[13] The Court in *Radford* utilized a present-value analysis to conclude that the Act would require the mortgagee "to relinquish his security not for its appraised value in cash, but for deferred payments which, if met, would yield (on a 6 per cent basis) only 76.6 per cent of the appraised value." *Radford*, 295 U.S. at 592 n.21. The Court recognized the time value of money, holding that the creditor's sale of its property at a specified market price in the future is not equivalent to an immediate sale of the property for cash at that price since the secured creditor does not obtain "the ordinary fruits of an immediate sale on deferred payments." *Radford*, 295 U.S. at 591.

The Court characterized the Act as compelling the creditor to provide the debtor with an unbargained-for option in the property, exercisable at an uncertain time during the five-year period of the moratorium, and noted the inequity of the limited conditions under which the court had the ability to terminate the debtor's control over the property:

> *The mortgagee is not only compelled to submit to the sale to the bankrupt, but to a sale made at such*

---

[12] The Frazier-Lemke Act was an emergency measure designed to protect farmers from the effects of the Great Depression. After *Radford*, the Frazier-Lemke Act was amended to reduce the moratorium granted a debtor on its mortgage payments from 5 years to 3 years as well as to provide the bankruptcy court with the ability to terminate the stay and order the sale of the property during the three-year period if appropriate. As interpreted by this Court in *Wright v. Vinton Branch of the Mountain Trust Bank of Roanoke*, 300 U.S. 440 (1937), the amended Frazier-Lemke Act did not create an absolute stay on the creditor's rights and instead vested the bankruptcy court with the power to order payments on a mortgagee's debt in addition to the reasonable rental value payments required to be made during the moratorium. In light of the discretion provided to the court to safeguard a mortgagee's interests during the moratorium, the constitutionality of the Act was upheld. *See Vinton Branch*, 300 U.S. at 460-64.

[13] The Court in *Radford* summarized the state law property rights of which the secured creditor was deprived as including "the right to realize upon the security by a judicial public sale" and "*the right to determine when such sale shall be held* subject only to the discretion of the court." (Emphasis added.) *Radford*, 295 U.S. at 594.

> *time as the latter may choose.* Thus, the bankrupt may leave it uncertain for years whether he will purchase; and in the end he may decline to buy. . . . *Such control leaves the court powerless to terminate the option unless there has been the commission of waste or failure to pay the prescribed rent.* [Emphasis added.]

Radford, 295 U.S. at 593.

The thrust of the *Radford* analysis of the impairment of the secured creditor's rights was not injury from depreciation of the collateral, the only interest the *Timbers* decision would permit to be protected, but rather the value of the creditor's interest in the property which is diminished through the passage of time while the creditor is stayed from foreclosing, even if the market price of the property remains unchanged. The Court expressly rejected the contention that this compelled delay, without compensation for the time value of money, impairs no substantive rights of the creditor so long as the appraised or market value of the collateral remains constant. *Radford*, 295 U.S. at 596.

While the decision in *Union Central*, referred to in the House and Senate Reports, defines the outer limits of the secured creditor's constitutionally protected property right as the value of the collateral, the *Radford* decision discusses interests of a secured creditor that are not constitutionally protected under *Union Central* but are nevertheless substantive rights bargained for in a secured transaction. The case references parallel the subsequent statements by Congress that the concept of adequate protection is not limited "strictly to the constitutional protection required" and is "based as much on policy" as on the Constitution. While, according to *Union Central*, the strict protections of the Constitution prevent the creditor only from suffering depreciation in the value of the property, the principles set forth in *Radford* embody interests much broader than those within the confines of the Constitution, consistent with the comments by the House.[14] The *Timbers* decision holds that Section 361 was designed to be nothing more than a restatement of the property rights protected by the Constitution, contrary to the express intent of Congress when it referred to *Radford* as the basis of the adequate protection concept and emphasized the secured creditor's right to have the "benefit of its bargain" and the "realization of value" protected.

IV. THE OUTER LIMITS OF *TIMBERS* ARE UNKNOWN.

The holding of *Timbers*, narrowly construed, may purport only to limit the adequate protection rights of an undersecured creditor whose collateral is proven to have a stable market price. However, the rationale of the decision and the Fifth Circuit's analysis of the rights and interests of secured creditors has dangerous implications for all secured creditors.

The court in *Timbers* equates the secured creditor's "interest in property" with its "allowed secured claim" for the purpose of adequate protection under Section 361. *Timbers*, 793 F.2d at 1399-1400. Interpreting Section 506, the court reasons that the creditor's allowed secured claim is in turn defined by the value of the property, even for an oversecured creditor, since post-petition interest on a secured claim is allowed only at the end of a case, after the estate's expenses for preservation of the property have been deducted and the court has found that the creditor is oversecured. *Timbers*, 793 F.2d at 1407-08. The court concludes that Section 361 was designed to protect the secured creditor only against "a decrease in the value of its collateral" since it is the property value that ultimately determines the "allowed secured claim," that is, the "interest in property" protected under Section 361. *Timbers*, 793 F.2d at 1416.

---

[14] The *Radford* decision could only have been cited for the principles it establishes since the *holding* regarding the constitutional implications of the Frazier-Lemke Act was in effect made irrelevant by the subsequent amendments to the Act. The constitutionality of the amended Act was confirmed in an opinion that was *not* referred to in the legislative history. *See Vinton Branch*, 300 U.S. at 440. If the intent of Congress was to limit the protection afforded under Section 361 to depreciation in the collateral, as *Timbers* holds, the reference to *Radford* becomes meaningless since that limited interest is dealt with in *Union Central*.

A long line of cases have evaluated a secured creditor's equity cushion to determine the extent to which the creditor is adequately protected, even when the property is not decreasing in value. *See Matter of Blazon Flexible Flyer, Inc.*, 407 F. Supp. 861 (N.D. Ohio 1976); *Com. of Pa. State Emp. Retirement Fund v. Roane*, 14 Bankr. 542 (E.D. Pa. 1981); *In re Rogers Dev. Corp.*, 2 Bankr. 679 (Bankr. E.D. Va. 1980); *In re Shockley Forest Industries, Inc.*, 5 Bankr. 160 (Bankr. N.D. Ga. 1980); *In re Breuer*, 4 Bankr. 499 (Bankr. S.D.N.Y. 1980). If adequate protection is limited only to the preservation of the value of the secured creditor's collateral, as *Timbers* holds, then *Timbers* also suggests that the traditional equity cushion analysis employed in those cases, and numerous others, is improper.

If the value of collateral is not declining, the erosion of a secured creditor's lien position through accruing interest and anticipated foreclosure costs would be *irrelevant* to the adequate protection determination, because, according to *Timbers*, the secured creditor's only interest is to have the value of the collateral preserved. Yet, jurisdictions that have refused to grant protection for an undersecured creditor's lost opportunity costs have nevertheless relied on an equity cushion to adequately protect an oversecured creditor from the damages occasioned by the delay in foreclosure or have found that periodic payments were required to preserve the oversecured creditor's lien position as a condition to the continuation of the stay. *See, e.g., In re LeMay*, 18 Bankr. 659 (Bankr. D. Mass. 1982); *In re Grant*, 29 Bankr. 375 (Bankr. M.D. Pa. 1983) (equity cushion and rental payments provide adequate protection). The implicit rationale of those decisions—*maintenance of the current value of the creditor's right to realize on its collateral*—requires that the undersecured creditor be afforded the same protection for its lost opportunity costs occasioned by the stay.

CONCLUSION

In a time of increasing failures, declining earnings and deteriorating asset quality in the lending industry, the *Timbers* decision may have profound repercussions for financial institutions nationwide, impairing the interests of both borrowers and lenders alike. In light of the implications of the ruling, the California League of Savings Institutions, the American Bankers Association, and the California Bankers Association respectfully submit that the decision of the United States Court of Appeals for the Fifth Circuit must be reversed.

Respectfully submitted,

JOHN A. GRAHAM
Counsel of Record
LESLEY ANNE HAWES
FRANDZEL & SHARE
A Law Corporation
8383 Wilshire Boulevard
Suite 400
Beverly Hills, California 90211
(213) 852-1000
Attorneys for Amici Curiae
California League of Savings Institutions, American Bankers Association, and California Bankers Association

AMICUS CURIAE

BRIEF

⑧

Supreme Court, U.S.
FILED
AUG 3 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1602

In The

Supreme Court of the United States

October Term 1987

United Savings Association of Texas,
Petitioner,

v.

Timbers of Inwood Forest Associates, Ltd.,
Respondent.

**On Writ of Certiorari to the United States
Court of Appeals for the Fifth Circuit**

BRIEF FOR NATIONAL COMMERCIAL FINANCE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

A. Bruce Schimberg*
Rex E. Lee
J. Ronald Trost
Shalom L. Kohn
Joel G. Samuels
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Counsel for Amicus Curiae
National Commercial
Finance Association

**Counsel of Record*

Of Counsel:

Frank R. Kennedy
Professor Emeritus
University of Michigan
Law School
Counsel, Sidley & Austin

40 pp

QUESTION PRESENTED

Amicus Curiae National Commercial Finance Association will address the following question:

Whether an undersecured creditor which is stayed by the filing of a bankruptcy petition from exercising its rights under applicable state law to foreclose on and sell its collateral and reinvest the proceeds is entitled, as "adequate protection" pursuant to Sections 361 and 362 of the Bankruptcy Code, to compensation for "lost opportunity costs"—*i.e.*, the economic harm it suffers because of the automatic stay of its rights to foreclose on its collateral and reinvest the proceeds.

TABLE OF CONTENTS

PAGE

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES........................ v

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 3

ARGUMENT 5

I. THE DELAY CAUSED BY THE AUTOMATIC STAY IN ENFORCING SECURITY INTERESTS IN BANKRUPTCY IS AN EXTRAORDINARY REMEDY THAT CONGRESS INTENDED TO CONTINUE ONLY AS LONG AS COMPENSATION FOR SUCH DELAY IS PROVIDED TO THE SECURED CREDITOR . 5

- A. The Historical Context—Relief from Stay Procedure Under the Bankruptcy Act 5
- B. The Congressional Response to Debtor Delay 6

II. THE VALUE OF A SECURED CREDITOR'S INTEREST IN COLLATERAL REQUIRED TO BE ADEQUATELY PROTECTED ENCOMPASSES *ALL* ITS RIGHTS WITH RESPECT TO SUCH COLLATERAL, INCLUDING THE CRITICAL RIGHT TO A PROMPT FORECLOSURE AND USE OF THE REALIZED PROCEEDS................................ 8

TABLE OF CONTENTS—Continued

PAGE

- A. Incorporation by Congress of the "Indubitable Equivalent" Standard in Section 361(3) of the Code Can Only Be Understood as Protecting the Present Value of the Secured Creditor's Interest in its Collateral 8
- B. The Legislative History of Section 361 of the Code Shows that Congress Intended to Protect the Value of All Attributes of a Secured Creditor's "Bargain" Under State Law.......... 10
- C. The Language and Legislative History of Section 1205 of the Code Clarify Congressional Intent that Section 361 Requires Time Value Compensation 12

III. DENIAL OF COMPENSATION FOR LOST OPPORTUNITY COSTS INTRODUCES ILLOGICAL INCONSISTENCIES TO THE CODE'S STATUTORY FRAMEWORK....... 16

- A. Comparative Treatment of Oversecured Creditors 16
- B. Comparative Treatment of Lessors......... 17
- C. Comparative Treatment of Administrative Costs................................ 18
- D. Financing Debtors and the Use of Cash Collateral 19
- E. Comparative Treatment of Undersecured Junior Lienors 20
- F. The Solvent Debtor Anomaly 21

TABLE OF CONTENTS—Continued

PAGE

IV. THE DECISION BELOW IS BASED ON A MISUNDERSTANDING OF THE HISTORY AND POLICY REGARDING THE TREATMENT OF POST-PETITION INTEREST IN BANKRUPTCY PROCEEDINGS 22

- A. The Decision Below Is Based on Three Fundamental Misconceptions 22
- B. Payment of Lost Opportunity Costs as Adequate Protection Is Consistent with the Policy and Historical Basis for the Principles Related to the Treatment of Interest in Bankruptcy .. 23
- C. The Code Provisions Dealing with Interest Do Not Preclude an Award of Lost Opportunity Costs as Part of Adequate Protection 27

V. CONCLUSION 29

TABLE OF AUTHORITIES

PAGE

American Anthracite & Bituminous Coal Corp. v. *Leonardo Arrivabene, S.A.*, 280 F.2d 119 (2d Cir. 1960) 18

American Iron & Steel Manufacturing Co. v. *Seaboard Air Line Railway*, 233 U.S. 261 (1914) 24

American Properties, Inc. v. *Topeka Bank and Trust (In re American Properties, Inc.)*, 8 Bankr. 68 (Bankr. D. Kan. 1980) 21

In re Bear River Orchards, 56 Bankr. 976 (Bankr. E.D. Cal. 1986) 20

Central Trust Co. v. *Bristol Mountain Enterprises, Inc. (In re Bristol Mountain Enterprises, Inc.)*, 13 Bankr. 412 (Bankr. W.D.N.Y. 1981) 21

Crocker Nat'l Bank v. *American Mariner Industries, Inc. (In re American Mariner Industries, Inc.)*, 734 F.2d 426 (9th Cir. 1984) 10, 11, 15

In re EES Lambert Associates, 62 Bankr. 328 (Bankr. N.D. Ill. 1986) 20

First Agricultural Bank v. *Jug End in the Berkshires, Inc. (In re Jug End in the Berkshires, Inc.)*, 46 Bankr. 892 (Bankr. D. Mass. 1985) 16, 17

Florida Nat'l Guard v. *Federal Labor Relations Authority*, 699 F.2d 1082 (11th Cir. 1983) 10

In re Garland Corp., 6 Bankr. 456 (BAP 1st Cir. 1980) 8

GATX Leasing Corp. v. *Airlift Int'l, Inc. (In re Airlift Int'l, Inc.)*, 761 F.2d 1503 (11th Cir. 1985) . 17

General Electric Credit Corp. v. *Levin & Weintraub (In re Flagstaff Foodservice Corp.)*, 739 F.2d 73 (2d Cir. 1984) 19

TABLE OF AUTHORITIES—Continued

	PAGE
Helvering v. *Stockholms Enskilda Bank*, 293 U.S. 84 (1934)	10
In re Int'l Hydro-Electric System, 101 F. Supp. 222 (D. Mass. 1951)	27
In re Johns-Manville Corp., 801 F.2d 60 (2d Cir. 1986)	8
Kingsail Corp. of Marathon, Inc. v. *Sombrero Reef Club, Inc. (In re Sombrero Reef Club, Inc.)*, 7 Bankr. 480 (Bankr. S.D. Fla. 1980)	21
Liberty Nat'l Bank & Trust Co. of Louisville v. *George*, 70 Bankr. 312 (W.D. Ky. 1987)	21, 22
Lorillard v. *Pons*, 434 U.S. 575 (1978)	10
Louisville Joint Stock Land Bank v. *Radford*, 295 U.S. 555 (1935)	14, 25, 26
Martin v. *United States (In re Martin)*, 761 F.2d 472 (8th Cir. 1985)	20
Metropolitan Life Insurance Co. v. *Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935)	9, 10
Midlantic Nat'l Bank v. *New Jersey*, 474 U.S. ____, 106 S. Ct. 755 (1986)	10
Nicholas v. *United States*, 384 U.S. 678 (1966) . .	26
Offshore Logistics, Inc. v. *Tallentire*, 477 U.S. ____, 106 S. Ct. 2485 (1986)	16
Phelps v. *United States*, 274 U.S. 341 (1927)	28, 29
In re Polries Brothers, 49 Bankr. 669 (Bankr. D.N.D. 1985)	21
Reading Co. v. *Brown*, 391 U.S. 471 (1968)	19
Red Lion Broadcasting Co. v. *Federal Communications Commission*, 395 U.S. 367 (1969)	12
Ridgewood Savings Bank v. *Houston (In re Houston)*, 32 Bankr. 584 (Bankr. S.D.N.Y. 1983) . . .	21
In re Schaller, 27 Bankr. 959 (W.D. Wisc. 1983) .	17

TABLE OF AUTHORITIES—Continued

	PAGE
Seatrain Shipbuilding Corp. v. *Shell Oil Co.*, 444 U.S. 572 (1980)	12
Sexton v. *Dreyfus*, 219 U.S. 339 (1911)	24, 26, 27
Sorenson v. *Secretary of the Treasury*, 475 U.S. ____, 106 S. Ct. 1600 (1986)	10
Thomas v. *Western Car Co.*, 149 U.S. 95 (1893) .	24
Ticonic National Bank v. *Sprague*, 303 U.S. 406 (1938)	23, 24, 25, 28
In re United Press Int'l, Inc., 60 Bankr. 265 (Bankr. D.D.C. 1986)	8
United Savings Association of Texas v. *Timbers of Inwood Forest Associates, Ltd. (In re Timbers of Inwood Forest Associates, Ltd.)*, 793 F.2d 1380 (5th Cir. 1986), *vacated and rehearing en banc granted*, 802 F.2d 777 (5th Cir. 1986) *(en banc)*, *reinstated*, 808 F.2d 363 (5th Cir. 1987) *(en banc)*	*passim*
United Savings Association of Texas v. *Timbers of Inwood Forest Associates, Ltd. (In re Timbers of Inwood Forest Associates, Ltd.)*, 808 F.2d 363 (5th Cir. 1987) *(en banc)*	*passim*
United States v. *Brown*, 333 U.S. 18 (1948)	15
United States v. *Security Industrial Bank*, 459 U.S. 70 (1982)	14, 25
Vanston Bondholders Protective Committee v. *Green*, 329 U.S. 156 (1946)	24, 26
In re Village Properties, Ltd., 723 F.2d 441 (5th Cir. 1984)	27
In re Weyland, 63 Bankr. 854 (Bankr. E.D. Wisc. 1986)	20
Wright v. *Union Central Life Insurance Co.*, 311 U.S. 273 (1940)	12
Wright v. *Vinton Branch of Mountain Trust Bank*, 300 U.S. 440 (1937)	13, 14

PAGE

In re Yale Express System, Inc., 384 F.2d 990 (2d Cir. 1967) ... 19

STATUTES

11 U.S.C. § 203(5) (repealed) ... 13, 14
11 U.S.C. § 207 (repealed 1978) ... 9
11 U.S.C. § 361 ... *passim*
11 U.S.C. § 361(1) ... 6
11 U.S.C. § 361(2) ... 6
11 U.S.C. § 361(3) ... 6, 8, 10, 13
11 U.S.C. § 362(a) ... 5
11 U.S.C. § 362(d) ... 6
11 U.S.C. § 362(d)(1) ... 6, 20
11 U.S.C. § 362(d)(2) ... 6
11 U.S.C. § 362(d)(2)(B) ... 7, 8
11 U.S.C. § 362(e) ... 7
11 U.S.C. § 363(c)(2) ... 20
11 U.S.C. § 363(e) ... 20
11 U.S.C. § 364 ... 19, 20
11 U.S.C. § 365(b) ... 18
11 U.S.C. § 502(b)(2) ... 23, 27
11 U.S.C. § 503(b) ... 18, 19
11 U.S.C. § 506(b) ... 23, 27, 28
11 U.S.C. § 506(c) ... 19, 21
11 U.S.C. § 507(a)(1) ... 18
11 U.S.C. § 507(a)(2) ... 18
11 U.S.C. § 507(a)(3) ... 18
11 U.S.C. § 507(a)(4) ... 18
11 U.S.C. § 507(a)(5) ... 18
11 U.S.C. § 507(a)(6) ... 18

PAGE

11 U.S.C. § 507(a)(7) ... 18
11 U.S.C. § 507(b) ... 17, 18, 19
11 U.S.C. § 546(b) ... 27
11 U.S.C. § 552(b) ... 27
11 U.S.C. § 725 ... 18
11 U.S.C. § 726(a)(1) ... 18
11 U.S.C. § 726(a)(2) ... 18
11 U.S.C. § 726(a)(3) ... 18
11 U.S.C. § 726(a)(4) ... 18
11 U.S.C. § 726(a)(5) ... 18, 21
11 U.S.C. § 726(a)(6) ... 18
11 U.S.C. § 1112 ... 8
11 U.S.C. § 1121 ... 8
11 U.S.C. § 1121(d) ... 8
11 U.S.C. § 1124(2) ... 18
11 U.S.C. § 1129(a)(7) ... 21
11 U.S.C. § 1129(b)(2)(A)(ii) ... 14
11 U.S.C. § 1129(b)(2)(A)(iii) ... 9
11 U.S.C. § 1205 ... 12, 13, 14, 15
11 U.S.C. § 1205(3) ... 13

RULES

Bankruptcy Rule 601(c) (superseded 1978) ... 5
Bankruptcy Rule 10-601(c) (superseded 1978) ... 5
Bankruptcy Rule 11-44(d) (superseded 1978) ... 5
Bankruptcy Rule 12-43(d) (superseded 1978) ... 5
Bankruptcy Rule 4001(a) ... 7
Bankruptcy Rule 4001(b) ... 7

	PAGE
LEGISLATIVE HISTORY	
H. Rep. No. 595, 95th Cong., 1st Sess. (1977)	6, 11, 12, 14
S. Rep. No. 989, 95th Cong., 2d Sess. (1978)	9, 10, 11, 12, 19
124 Cong. Rec. H11,092 (Sept. 28, 1978)	19
132 Cong. Rec. S5,558 (May 7, 1986)	14
132 Cong. Rec. S15,075 (Oct. 3, 1986)	13, 15
H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. (1986)	13, 15
SECONDARY SOURCES	
Annotation, *Rights and Powers of Trustee or Assignee in Bankruptcy as Regards Property of Bankrupt Which Is Subject to a Valid Lien*, 75 L. Ed. 645 (1930)	5
Annotation, *What Constitutes Lack of "Adequate Protection" of Interest in Property of Estate for Which Relief May Be Granted from Automatic Stay Provision of Bankruptcy Code of 1978*, 66 A.L.R. Fed. 505 (1984)	17
2 Blackstone, *Commentaries* (1766)	23
W. Blum, *Treatment of Interest on Debtor Obligations in Reorganizations Under the Bankruptcy Code*, 50 U. CHI. L. REV. 430 (1983)	26, 27
2 *Collier on Bankruptcy* ¶ 365.03[3] (15th ed. 1986)	17, 18
3 *Collier on Bankruptcy* ¶ 507.02[2] (15th ed. 1986)	18, 19
F. Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. MICH. J.L. REF. 3 (1978)	5
Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. CHI. L. REV. 305 (1983)	19

No. 86-1602

In The
Supreme Court of the United States
October Term 1987

United Savings Association of Texas,
Petitioner,

v.

Timbers of Inwood Forest Associates, Ltd.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF FOR NATIONAL COMMERCIAL FINANCE ASSOCIATION AS AMICUS CURIAE IN SUPPORT OF PETITIONER

INTEREST OF AMICUS CURIAE[1]

The National Commercial Finance Association ("NCFA") is the national trade association for the commercial finance industry. It has more than 230 members, including small enterprises, large publicly-held companies, banks, and subsidiaries of bank holding companies.

The heart of the commercial finance business is asset-based financing. NCFA members extend secured credit to businesses on a national, regional and local scale, often through the financing of accounts receivable and inventory on a revolving basis. Most of these businesses are small and medium-sized enterprises which depend upon the availability of secured financing for their existence and growth. In response to the rapidly expanding needs of such borrowers, asset-based commercial financing has grown dramatically since the 1950's and has become a significant part of the national credit market. Total outstanding secured financing extended by NCFA members exceeds $68 billion.

---

[1] This Brief is filed with the consent of the parties; a letter reflecting such consent is on file with the Clerk of the Court.

A business required to borrow on a secured basis is usually a greater credit risk than a borrower with available unsecured lines. Lenders that obtain collateral to protect against that increased risk of default draft their loan agreements to facilitate prompt realization of collateral value by sale under Article 9 of the Uniform Commercial Code, or other applicable state and federal laws, in the event of bankruptcy or other insolvency proceedings.

The decision of the Fifth Circuit below undermines the protection which secured lenders require and expect when collateral is obtained to secure a borrower's obligation. That decision deprives secured creditors, without compensation, of state law rights to foreclose on their collateral and reinvest the proceeds in their businesses. Debtors are given the corresponding ability, upon the filing of a bankruptcy petition, to use collateral for the duration of the proceeding without paying for that benefit. In economic and practical terms, the effect of the Fifth Circuit's decision is to transfer value from the secured creditor, who bargained for collateral and its related benefits as part of its loan, to debtors and unsecured creditors, all of whom have interests in the estate subordinate to that of the secured creditor.

Apart from the unfairness of this involuntary transfer of value to junior interests, the effect of the decision below is to encourage bankruptcy filings instead of out-of-court negotiated restructurings which otherwise may be more efficient. Under the decision below, debtors and unsecured creditors also have a powerful incentive to delay bankruptcy proceedings so as to prolong the benefits of the cost-free use of pledged property used in the debtors' business while creditors need not be paid. One practical result is that secured creditors will be forced, during negotiations, to compromise their substantive rights in order to end the erosion of their economic position through continued delay.

The NCFA, for the secured lending industry, actively participated in the legislative process leading to the 1978 adoption of the Bankruptcy Code ("Code"). One of its significant objectives was to preserve the ability of secured creditors to foreclose on collateral and reinvest the proceeds, a right which pre-Code jurisprudence generally recognized but which in practice was often frustrated by procedural delays. The congressional response was to require "adequate protection" of the value of all the secured creditor's rights in collateral which the debtor wished to use. That concept of adequate protection is at the heart of this case.

The NCFA is filing this *amicus* brief to seek reversal of the decision of the Fifth Circuit below, the only Court of Appeals decision which, contrary to the decisions of three other Courts of Appeals, excludes from the scope of "adequate protection" the most critical aspect of the secured creditor's bargain in making a secured loan—the right to foreclose on collateral and promptly reinvest the proceeds.

SUMMARY OF ARGUMENT

Section 361 of the Code requires "adequate protection" of the "value" of the "interest" of a secured creditor in collateral which a debtor seeks to use in its business. The legislative history is explicit that Congress intended "to insure that the secured creditor receives in value essentially what he bargained for." The most critical part of that bargain is the secured creditor's right to foreclose on its collateral upon default and reinvest the proceeds, a right which is automatically stayed in bankruptcy. Nevertheless, the Fifth Circuit would deny secured creditors any compensation for deprivation of that valuable right.

This conclusion is contrary to the statutory language. Section 361 uses terms of art such as "indubitable equivalent" which have long reflected the economic truth that a dollar today is worth more than a dollar in the future because it can be reinvested in the interim, and that "adequate protection" is not adequate unless compensation is paid for any foregone reinvestment opportunities. The Fifth Circuit also pays insufficient deference to the legislative intent to protect the "bargain" of secured creditors, and dismisses without basis the unequivocal statements of Congress, in enacting the Family Farmer Act in 1986, that Section 361 requires the very type of compensation which the Fifth Circuit denied.

In addition, the decision below introduces a host of inconsistencies in the treatment of various entities whose property interests are used by a debtor. In every other context, the Code provides that the debtor which seeks to enhance its rehabilitation by using property in which another entity has an interest must pay for that use. The debtor accordingly must provide compensation, out of otherwise unencumbered assets, to pre-petition lessors, creditors whose collateral value exceeds their claims, and others providing comparable benefits to the estate during the course of its bankruptcy proceeding. Nothing in the language, logic, or policy of the Code supports the Fifth Circuit's unequal treatment of one group of creditors—those whose claims exceed the value of their collateral—providing a valuable benefit to the estate, a result which prevents the statute from being interpreted consistently and as a coherent whole.

Finally, the Fifth Circuit misconstrues the history and policy of the interest provisions of the Code by analyzing adequate protection payments designed to compensate undersecured creditors for impairment of property rights as nothing more than impermissible post-petition interest. The interest provisions measure an entirely different right, which is computed in a different manner and at a different time than the right of secured creditors to adequate protection. In fact, by requiring secured creditors to subsidize unsecured creditors through the debtor's cost-free use of collateral, the decision below has created the very sort of inequity which the rules regarding post-petition interest were designed to avoid.

ARGUMENT

I.

THE DELAY CAUSED BY THE AUTOMATIC STAY IN ENFORCING SECURITY INTERESTS IN BANKRUPTCY IS AN EXTRAORDINARY REMEDY THAT CONGRESS INTENDED TO CONTINUE ONLY AS LONG AS COMPENSATION FOR SUCH DELAY IS PROVIDED TO THE SECURED CREDITOR

A. The Historical Context—Relief from Stay Procedure Under the Bankruptcy Act

Under Section 362(a) of the Code, as under pre-Code law, a secured creditor is stayed from enforcing its rights in collateral upon the filing of a bankruptcy petition. 11 U.S.C. § 362(a).

Pre-Code jurisprudence generally permitted a secured creditor to obtain relief from the stay if the debtor had no equity in the property—*i.e.*, if the creditor was undersecured. See Petitioner's Brief at 19-25; Annotation, *Rights and Powers of Trustee or Assignee in Bankruptcy as Regards Property of Bankrupt Which Is Subject to a Valid Lien*, 75 L. Ed. 645, 654-55 (1930). Once granted such relief, the undersecured creditor could foreclose on its collateral and reinvest the proceeds.

In practice, however, and notwithstanding Bankruptcy Rules ostensibly requiring prompt hearings when relief was sought from the stay,[2] judicial delays were common. Hearings on complaints for relief from the stay often were not scheduled promptly or were frequently continued, and determinations on the merits were "taken under advisement" for months without a ruling. In the interim, the injunction against lien enforcement continued, to the severe detriment of secured lenders. *See generally* F. Kennedy, *Automatic Stays Under the New Bankruptcy Law*, 12 U. MICH. J.L. REF. 3, 40-41 (1978). The undersecured creditor's right to foreclose upon property in which the debtor had no equity was thus frustrated by ineffective procedure and the unstated but evident desire of bankruptcy judges to preserve the debtor's use of property potentially useful in its business.

---

[2] Bankruptcy Rules 601(c) (liquidation), 10-601(c) (Chapter X), 11-44(d) (Chapter XI), and 12-43(d) (Chapter XII) (superseded 1978).

B. The Congressional Response to Debtor Delay

Congress was cognizant of the frequent abuses of stays in bankruptcy proceedings when it enacted the Code in 1978.[3] It adopted a series of interrelated policies to balance the competing interests in collateral more fairly. Property in which the debtor had no equity could still be retained and used, if "necessary to an effective reorganization." 11 U.S.C. § 362(d)(2). But as a condition to the debtor's use of collateral, Congress required the satisfaction of two countervailing safeguards: (1) the requirement of "adequate protection" of the "value" of the secured creditor's "interest" in its collateral; and (2) the right of a secured creditor seeking relief from the stay to a prompt hearing.

The first safeguard—adequate protection of the value of the secured party's interest in its collateral—was enacted in Sections 362(d) and 361 of the Code.[4] The second safeguard—a prompt

---

[3] *See* H. Rep. No. 595, 95th Cong., 1st Sess. at 175, 181 (1977) ("House Report") (noting that "delay . . . amounts to a complete denial or relief" and that "[t]he secured creditor is entitled to . . . not have his collateral eroded by delay or by use by the estate").

[4] Section 362(d) provides, in relevant part:

> On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—
>
> (1) for cause, including the lack of adequate protection of an interest in property of such party in interest . . . .

11 U.S.C. § 362(d).

Illustrations of "adequate protection" are contained in § 361 of the Code. Section 361 provides that, when adequate protection is required "of an interest of an entity in property," it may be provided by "periodic cash payments" or an "additional or replacement lien" to the extent that "the stay . . . results in a decrease in the value of such entity's interest in such property," 11 U.S.C. §§ 361(1), 361(2), or other relief "as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property," 11 U.S.C. § 361(3). These examples of adequate protection are illustrative only; the precise method by which adequate protection is to be determined is "left to case-by-case interpretation and development." House Report at 339.

hearing on the propriety of continuing the stay—was enacted in Section 362(e) of the Code, which provides for automatic termination of the stay if the court does not timely hear and rule on a motion for relief. *See* Bankruptcy Rule 4001(a)-(b).

There is no evidence that, in attempting to eliminate the *procedural* flaws which impaired the prompt and proper protection of the rights of secured creditors, Congress intended to diminish the *substantive* protection to which such creditors were entitled under pre-Code law. To the contrary, the concept of "adequate protection" which the Code introduced as compensation for maintenance of the stay was a measure designed entirely to protect secured creditors' rights, not diminish them. The decision below is contrary to the thrust of the legislation enacting the Code, and undermines the significant improvements which the asset-based lending industry sought and understood it had obtained.

Moreover, the Fifth Circuit's decision can be expected to exacerbate the delays which Congress sought to limit by enacting Sections 361 and 362(e) of the Code. Under the majority's approach, the undersecured creditor's collateral may be used *indefinitely*, without compensation, for the benefit of the debtor and its unsecured creditors, particularly when the collateral (such as land) is not depreciating in value. This encourages debtors to delay the proceedings as long as possible, so as to maximize this windfall of using property without compensation.

As its antidote for this delay, the *en banc* majority proposes three potential creditors' remedies. 808 F.2d at 370-72.[5] Each of these can occur only upon the exercise by the bankruptcy judge of considerable discretion. None is likely to be effective.[6] As the dis-

---

[5] For convenience, citations to the panel opinion of the Fifth Circuit, reported at 793 F.2d 1380 (5th Cir. 1986), and the *en banc* opinion of the Fifth Circuit reinstating the panel opinion, reported at 808 F.2d 363 (5th Cir. 1987) *(en banc)*, are indicated solely by reference to the applicable pages of the Federal Reporter.

[6] The first alternative proposed by the majority is a bankruptcy court finding that the collateral is "not necessary to an effective reorganization." 11 U.S.C. § 362(d)(2)(B). As the majority recognizes, this is a standard which bankruptcy judges tend to apply with "indulgence," 808 F.2d at 371, and which is often held to permit use of property even to

(Footnote continued on following page)

sent correctly noted, "[t]he trouble with [these] creditors' remedies . . . is that in practice, as shown by the case statistics, they have not been enforced." 808 F.2d at 383 (Jones, J., dissenting). There is no reason to suppose that bankruptcy judges, which permitted delay in enforcement of secured creditors' rights prior to enactment of the Code, and which have not enforced "creditors' remedies" since the Code has been adopted, would somehow change these practices if the Fifth Circuit's decision were upheld.

II.

THE VALUE OF A SECURED CREDITOR'S INTEREST IN COLLATERAL REQUIRED TO BE ADEQUATELY PROTECTED ENCOMPASSES *ALL* ITS RIGHTS WITH RESPECT TO SUCH COLLATERAL, INCLUDING THE CRITICAL RIGHT TO A PROMPT FORECLOSURE AND USE OF THE REALIZED PROCEEDS

A. Incorporation by Congress of the "Indubitable Equivalent" Standard in Section 361(3) of the Code Can Only Be Understood as Protecting the Present Value of the Secured Creditor's Interest in Its Collateral

The most persuasive indication of congressional intent is the language of the Code, which uses two terms of art—"indubitable equivalent" and "adequate protection"—that incorporate the concept of protecting the present value of the secured creditor's collateral. The term "adequate protection" is derived from Section 77B of the former Bankruptcy Act, 11 U.S.C. § 207 (repealed 1978). The term "indubitable equivalent" is derived from *Metropolitan Life Insurance Co.* v. *Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), in which Judge Hand explained the scope of "adequate protection" in Section 77B:

> In construing so vague a grant, we are to remember not only the underlying purposes of the section, but the constitutional limitations to which it must conform. *It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference,* but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property. We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most *indubitable equivalence.*

75 F.2d at 942 (emphasis added).

To Congress, "adequate protection" meant no less than "indubitable equivalent"; and "indubitable equivalent" was a term of art with a well-established meaning. It required compensation not only for the nominal value of collateral, but for its time value as well—*i.e.*, the secured creditor's ability to reinvest the proceeds of foreclosure. *See* 808 F.2d at 377 (Jones, J., dissenting).

This conclusion is strongly supported by Congress' use of the same phrase "indubitable equivalent" in Section 1129(b)(2)(A)(iii) of the Code, as an alternative measure of the compensation which must be received by a secured creditor in order for a plan of reorganization to be confirmed over its objection. There is no doubt, as the panel opinion admits, 793 F.2d at 1388-89, that "indubitable equivalent" was used in Section 1129(b)(2)(A)(iii) to codify *Murel* and to require that the *present value,* and not just the nominal value, of all aspects of the secured creditor's interest in its collateral be protected in the context of a plan. S. Rep. No. 989, 95th Cong., 2d Sess. at 127-28 ("Senate

---

(Footnote continued from previous page)
facilitate an effective liquidation. *Id.* at 371 n.14. The second alternative, the filing of a creditors' plan after the expiration of the debtor's 120-day exclusivity period, 11 U.S.C. § 1121, is subject to the bankruptcy judge's discretion to extend that exclusivity period for "cause," 11 U.S.C. § 1121(d)—which bankruptcy judges routinely do, particularly in cases of any size or complexity. *See, e.g., In re United Press Int'l, Inc.*, 60 Bankr. 265, 266, 269 (Bankr. D.D.C. 1986) (exclusivity period extended from time to time for more than a year); *In re Johns-Manville Corp.*, 801 F.2d 60, 62 (2d Cir. 1986) (noting that exclusivity period had been extended for three to four years). (In addition, because unsecured creditors are the principal beneficiaries of the debtor's cost-free use of undersecured creditors' collateral, the undersecured creditor's ability to propose and confirm a plan of reorganization is problematic, to say the least.) Finally, the "prime avenue for relief" identified by the majority—the conversion or dismissal of the case under Section 1112—has such draconian implications for the debtor and other creditors that it is a remedy of last resort, invoked by a bankruptcy judge only in the rarest of cases and after considerable delay. *See In re Garland Corp.*, 6 Bankr. 456, 460 (BAP 1st Cir. 1980).

Report") ("The indubitable equivalent language is intended to follow the strict approach taken by Judge Learned Hand in *In Re Murel Holding Corp.*, 75 F.2d 941 (2nd Cir. 1935)").

It is a well-settled and common sense rule of statutory construction that "identical words used in different parts of the same act are intended to have the same meaning." *Sorenson* v. *Secretary of the Treasury*, 475 U.S. ___, 106 S. Ct. 1600, 1606 (1986), *quoting Helvering* v. *Stockholms Enskilda Bank*, 293 U.S. 84, 87 (1934). The court below ignores this rule, and instead simply *speculates* as to why the "indubitable equivalent" language *might* have been inserted into Section 361 and what it *might* have been intended to mean. *See* 793 F.2d at 1400-01. None of this justifies ignoring the clear meaning of that term of art, or the majority's conclusion that the identical words in the same statute should be interpreted differently.[7] *See* 808 F.2d at 378 (Jones, J., dissenting). *See also Florida Nat'l Guard* v. *Federal Labor Relations Authority*, 699 F.2d 1082, 1087 (11th Cir. 1983) ("Congress is deemed to know the . . . judicial gloss given to certain language and thus adopts the existing interpretation unless it affirmatively acts to change that meaning"), citing *Lorillard* v. *Pons*, 434 U.S. 575, 580-81 (1978).

B. The Legislative History of Section 361 of the Code Shows that Congress Intended to Protect the Value of All Attributes of a Secured Creditor's "Bargain" Under State Law

An important aspect of a secured creditor's bargained-for rights—and the primary reason for obtaining collateral—is the ability, upon default, to sell collateral and reinvest the proceeds in the lender's business for whatever return on assets exists for that business. *See Crocker Nat'l Bank v. American Mariner Industries, Inc. (In re American Mariner Industries, Inc.)*, 734 F.2d 426, 435 (9th Cir. 1984). This foreclosure right is central to the

---

[7] The panel opinion notes that "'[t]he normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific,'" 793 F.2d at 1390, *quoting Midlantic Nat'l Bank* v. *New Jersey*, 474 U.S. ___, 106 S. Ct. 755, 760 (1986). Inexplicably, it does not follow this rule when analyzing the meaning of "indubitable equivalent" in § 361(3).

secured creditor's business, which requires it to earn more on funds which it lends than its cost of those funds. When funds are tied up and not earning a return because of a judicial stay of foreclosure rights, the secured lender suffers a serious and continuing loss for which it is unprotected. *Id.*

The legislative history of Section 361 of the Code reveals that Congress sought to protect the value of *all* rights of secured creditors under state law. The House Report emphasizes that "adequate protection" is intended to insure that secured creditors will receive the "benefit of their bargain":

> The concept [of adequate protection] is derived from the fifth amendment protection of property interests . . . The section [§ 361], and the concept of adequate protection, is based as much on policy grounds as on constitutional grounds. *Secured creditors should not be deprived of the benefit of their bargain.* There may be situations in bankruptcy where giving a secured creditor an absolute right to his bargain may be impossible or seriously detrimental to the bankruptcy laws. Thus, this section recognizes the availability of alternate means of protecting a secured creditor's interest. *Though the creditor might not receive his bargain in kind, the purpose of the section is to insure that the secured creditor receives in value essentially what he bargained for.*

House Report at 339 (emphasis added). *See also* Senate Report at 49.

The court below best described the bargain which Congress sought to protect—"it seems likely that the bargain referred to is the bargain to receive the collateral or its value *upon default*." 793 F.2d at 1397 (emphasis added). This bargain is hardly protected if the right to receive collateral *upon default* and reinvest the proceeds is deferred for months or even years without compensation for "lost opportunity costs"—the loss of potential earnings on reinvestment of the collateral proceeds.

In refusing to recognize lost opportunity costs as an element of adequate protection, the Fifth Circuit notes that otherwise, "total adequate protection payments will in many, perhaps most, cases approximate the principal and interest payments required by the existing terms of the secured debt instruments." 793 F.2d at 1408. The legislative history shows that this is a possibility which

Congress expressly contemplated. Senate Report at 54 (adequate protection payments under Section 361 "might, but need not necessarily, be in the same amount as payments due on the secured obligation").

Finally, Congress explicitly noted that adequate protection was "not intended to be confined strictly to the constitutional protection required. . . ." House Report at 339. Although *amicus* agrees with Professor Jackson that payment for lost opportunity costs is also of constitutional dimension, *see* Amicus Brief of Prof. Thomas Jackson ("Jackson Amicus Brief"), at 8 n.8, *supra* at 13 n.10, it is undeniable (and the Fifth Circuit concedes, 793 F.2d at 1390 n.14) that the Constitution requires at least protection of the secured creditor's rights "to the extent of the value of the property." ***Wright*** *v. Union Central Life Insurance Co.*, 311 U.S. 273, 278 (1940). However, by limiting adequate protection to compensation for declines in collateral value, 793 F.2d at 1397-98, the Fifth Circuit has "confined" adequate protection to a narrowly-defined constitutional minimum, in disregard of congressional intent to provide *greater* protection than the Constitution requires.

C. The Language and Legislative History of Section 1205 of the Code Clarify Congressional Intent that Section 361 Requires Time Value Compensation

If there were any doubt whether "adequate protection" as used in Section 361 requires compensation for lost opportunity costs, such doubt was eliminated in 1986 when Congress amended the Code to create a new chapter (Chapter 12), including a new adequate protection provision, Section 1205, for "family farmers".[8]

Unlike Section 361, which protects the value of an "interest in property," Section 1205 expressly limits the scope of adequate protection to the extent of decreases "in the value of property securing a claim." 11 U.S.C. § 1205. This seemingly modest change in language—between the value of an "interest" in

---

[8] "[W]hile the views of subsequent Congresses cannot override the unmistakable intent of the enacting one . . . , such views are entitled to significant weight . . . and particularly so when the precise intent of the enacting Congress is obscure." ***Seatrain Shipbuilding Corp.*** **v.** ***Shell Oil Co.*****, 444 U.S. 572, 596 (1980).** ***See also Red Lion Broadcasting Co.*** **v.** ***Federal Communications Commission*****, 395 U.S. 367, 380-81 (1969) ("Subsequent legislation declaring the intent of an earlier statute is entitled to great weight in statutory construction").**

property and the value of "property"—was explicitly intended by Congress to relieve family farmers from the obligation otherwise applicable under Section 361 to make lost opportunity cost payments: "[Section 1205] eliminates the need of the family farmer to pay lost opportunity costs, . . . and makes it clear that what needs to be protected is the value of property, not the value of the creditor's 'interest' in property." H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. at 49-50 (1986). Congress knew how to limit adequate protection to a decline in the value of collateral when it wished to do so—and it did so only in Section 1205 for family farmers, not in Section 361.

It is also significant that Congress sought to prevent the awarding of lost opportunity costs as adequate protection under the newly-enacted Chapter 12 by omitting the "indubitable equivalent" language used in Section 361(3).[9] In its place, Section 1205 provides for adequate protection in the form of "reasonable rent customary in the community where the property is located, based upon the rental value, net income, and earning capacity of the property. . . ." 11 U.S.C. § 1205(3).

The significance of this "reasonable rent" alternative is twofold. First, while adopting a relief measure for family farmers, Congress "squarely recognize[d] the secured creditor's entitlement to compensation for delay during bankruptcy," and provided for reasonable market rent as "the quintessential measure of the time-value of real property." 808 F.2d at 379 (Jones, J., dissenting). *See also* Jackson Amicus Brief, at 16-17.[10]

---

[9] That Congress omitted the "indubitable equivalent" language from Section 1205 in order to make clear that family farmer debtors need not make lost opportunity cost payments is evidenced by the legislative history to that Section: "[S]ection 1205 . . . eliminates the need of the family farmer to pay lost opportunity costs, and adds another means for providing adequate protection for farmland—paying reasonable market rent. Section 1205 eliminates the 'indubitable equivalent' language of 11 USC 361(3) and makes it clear that what needs to be protected is the value of property, not the value of the creditor's 'interest' in property." H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. at 49-50 (1986). *See also* 132 Cong. Rec. S15,075 (Oct. 3, 1986) (remarks of Sen. Thurmond).

[10] In adopting this measure for interim rent, Congress cited the similar provision of the amended Frazier-Lemke Act (49 Stat. 943-945, 11 U.S.C. § 203(5)), which this Court upheld in ***Wright*** **v.** ***Vinton Branch of***

(Footnote continued on following page)

Moreover, in enacting this subsection, Congress explicitly described this measure as a fair substitute for what the secured creditor would obtain if it were able to foreclose on its collateral:

> Allowing the debtor to provide adequate protection by paying rent recognizes the economic realities of foreclosure. During a time of depressed farm values, the lender will usually be the high bidder at a foreclosure sale. If the lender cannot resell the property, it typically will rent the property at the market rate. *If the debtor pays market rent while he reorganizes, the lender will be getting only what it would realistically get as a result of foreclosure.*

132 Cong. Rec. S5,558 (May 7, 1986) (detailed analysis of proposed 11 U.S.C. § 1222, which became Section 1205) (emphasis added). Given Congress' protection of the time value of secured creditors' foreclosure rights—albeit measured by rent—in Section 1205, it is difficult to conclude, as does the majority below, that such protection is absent in Section 361.

Second, the decision below would have the anomalous effect of treating family farmer debtors in a worse manner than non-family farmer debtors. Contrary to the clear congressional intent to improve the plight of family farmers compared to other debtors under the Code, family farmer debtors would be required to pay for lost opportunity costs through "reasonable rent" (if they cannot otherwise provide adequate protection), while other debtors, according to the decision below, need not make such payments, *or any payments at all,* to undersecured creditors unless the collateral is depreciating. "Poignantly, farmers in the Fifth Circuit will henceforth bear a higher adequate protection burden under this 'relief' provision of the Family Farmer Act than will non-farm debtors. Congress could not have intended this cruel paradox." 808 F.2d at 379 (Jones, J., dissenting). *See also United States* v. *Brown,* 333 U.S. 18, 27 (1948) (statute should not be interpreted so as to result in "patently absurd consequences" contrary to evident legislative intent).

The *en banc* majority opinion is sensitive to these implications of the enactment of Section 1205, and labors unsuccesfully to avoid them. The majority asserts, for example, that "virtually all" of the witnesses testifying "excoriated the *American Mariner* result." 808 F.2d at 364, 369. This is not only factually untrue, 808 F.2d at 378 (Jones, J., dissenting), but ignores the context of the criticism, which was limited to a concern about the effect of the decision on family farmers, and not the correctness of the decision or its impact on debtors generally. *See* H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. at 49-50 (1986); 132 Cong. Rec. S15,075 (Oct. 3, 1986) (remarks of Sen. Thurmond).

While Congress may have been "responding to a specific problem—that of family farm bankruptcies—with a bill of limited scope," 808 F.2d at 369, Congress had ample opportunity to legislatively overrule *American Mariner* or otherwise express the opinion that it was wrongly decided. Congress did not do so. Instead, it spoke of "the *need* of the family farmer to pay lost opportunity costs" under present law. H.R. Conf. Rep. No. 958, 99th Cong., 2d Sess. at 49 (1986) (emphasis added). There is no basis for this Court to interpret the Code in a different way from the expressed intent of Congress.

(Footnote continued from previous page)
Mountain Trust Bank, **300 U.S. 440 (1937). 132 Cong. Rec. S5,558 (May 7, 1986). Prior to its amendment, the Frazier-Lemke Act had been held unconstitutional on the ground that it permitted debtors to retain property subject to a lien by paying its appraised value over time, with interest at only 1%—resulting in payments whose present value was less than the value of the property. *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555, 591 (1935); *United States* v. *Security Industrial Bank,* 459 U.S. 70, 76 n.7 (1982) (explaining and citing *Radford* with approval). The decision below revives the infirmities which resulted in *Radford's* invalidation of the original Frazier-Lemke Act. It again permits debtors to retain property subject to a lien, and so long as they make adequate protection payments equal to any depreciation in value, in effect to pay that value over time—without *any* interest, not even 1%. *See* 11 U.S.C. § 1129(b)(2)(A)(II) (permitting plan to be confirmed over secured creditor's objection if creditor is given the economic equivalent of the value of its collateral as of the date of the plan). It is hardly imaginable that Congress, which described "the concept of adequate protection" as "derived from the fifth amendment protection of property interests" as enunciated by the Supreme Court, House Report at 339 (citing *Radford*), intended to treat secured creditors in a manner inferior to that which *Radford* found unlawful.**

III.

DENIAL OF COMPENSATION FOR LOST OPPORTUNITY COSTS INTRODUCES ILLOGICAL INCONSISTENCIES TO THE CODE'S STATUTORY FRAMEWORK

It is a fundamental principle of statutory construction that a statute must be interpreted so as to produce a harmonious whole, because Congress is presumed to have had a uniform purpose and intent with respect to the entire statute. *See Offshore Logistics, Inc.* v. *Tallentire*, 477 U.S. ___, 106 S. Ct. 2485, 2494 (1986). To construe "adequate protection" as excluding appropriate compensation for lost opportunity costs, as did the court below, generates a host of inconsistencies with other provisions of the Code. None of these inconsistencies is warranted by the plain meaning of the statute or its legislative history.

A. Comparative Treatment of Oversecured Creditors

The rule adopted below produces illogical inconsistencies in the treatment among secured creditors with respect to their right to obtain adequate protection under Section 361, based on the fortuitous happenstance of whether, at the time of bankruptcy, the collateral is sufficient to pay all or only part of the secured claim. Under the Fifth Circuit's approach, an undersecured creditor —even one whose collateral value is only slightly less than its claim—would not be entitled to *any* compensation for the debtor's continued use of its property (except to the extent of any physical deterioration), while the automatic stay prevents it from liquidating its collateral and reinvesting the proceeds.

The treatment of a slightly oversecured creditor, such as one whose collateral exceeds its claim by a mere $1,000, is radically different. As a result of the insufficiency of its small "equity cushion," this creditor would be granted relief from the stay, unless the debtor furnished adequate protection through periodic cash payments, replacement liens from otherwise unencumbered property, or other means constituting "indubitable equivalent."[11]

---

[11] ***See, e.g., First Agricultural Bank*** v. ***Jug End in the Berkshires, Inc. (In re Jug End in the Berkshires, Inc.)***, 46 Bankr. 892, 899-900 (Bankr. D. Mass. 1985) (equity cushion of 8.3% insufficient to provide adequate protection "in the face of the continuous erosion of that cushion by daily

(Footnote continued on following page)

In addition, if the adequate protection afforded the oversecured creditor proves to have been inadequate, the deficiency claim is treated as a "super-priority" administrative claim, with priority over claims of unsecured creditors as well as all other administrative claims, as supplemental compensation. 11 U.S.C. § 507(b).

There is no basis in logic, policy or statutory language to distinguish between these two creditors as to the common economic loss from their inability to liquidate collateral and reinvest the proceeds. In each case, the debtor is using the creditor's collateral to achieve its own rehabilitation. In one case, the costs of delay are borne entirely by the undersecured creditor, while the debtor is permitted to use the collateral without any compensation for the delay. In the second case, the costs of delay are borne by the debtor's unsecured creditors and shareholders, through periodic cash payments, replacement liens in unencumbered assets, or other "indubitable equivalent."

To treat marginally oversecured and marginally undersecured creditors differently with respect to a common economic loss cannot be explained or justified. There is a single statutory directive in Section 361—to provide "adequate protection" of the "value" of the "interest" of a secured creditor in property subject to its lien. The "interest" of the slightly oversecured and slightly undersecured creditor in the above example is identical, except for an insignificant difference in collateral value. Yet, according to the rule adopted below, the "adequate protection" which each receives as protection for that virtually identical interest is radically different.

B. Comparative Treatment of Lessors

A debtor using property which it had leased pre-petition is required to pay the lessor the fair and reasonable rental value of that leased property pending its decision whether to assume or reject the lease. *GATX Leasing Corp.* v. *Airlift Int'l, Inc. (In re Airlift Int'l, Inc.)*, 761 F.2d 1503, 1508 (11th Cir. 1985); 2 *Collier*

(Footnote continued from previous page)

interest costs"); ***In re Schaller***, 27 Bankr. 959, 962 (W.D. Wisc. 1983) (accord where equity cushion 17-18%). ***See generally*** Annotation, ***What Constitutes Lack of "Adequate Protection" of Interest in Property of Estate for Which Relief May Be Granted from Automatic Stay Provision of Bankruptcy Code of 1978***, 66 A.L.R. Fed. 505, 522-26 (1984) (and cases cited).

on Bankruptcy ¶ 365.03[3], at 365-32:33 (15th ed. 1986). This rule is based on notions of unjust enrichment which recognize that a debtor must pay for the benefit it obtains from the use of a lessor's property. *American Anthracite & Bituminous Coal Corp.* v. *Leonardo Arrivabene, S.A.*, 280 F.2d 119, 126 (2d Cir. 1960).

It makes little sense—as the decision below would require—to treat secured creditors and lessors differently for adequate protection purposes. Both the lessor and the secured lender have an interest in property which serves as a means of assuring priority over unsecured creditors in repayment of the contracted-for return on their investment. Both are restrained from exercising their rights under state law to repossess and dispose of the property in which they have an interest, and both are at risk that the property may depreciate during the stay period. Both may be compelled to have their contracts reinstated. 11 U.S.C. §§ 365(b), 1124(2). In short, both lose the value of their property rights either to relet the property or reloan the proceeds of the property at then current market rates, and, in both cases, the debtor is using the property for its rehabilitation. There is thus no reason, either as a matter of statutory construction or bankruptcy policy, to compensate lessors but not undersecured lenders for the delay in enforcement of their state law rights.

C. Comparative Treatment of Administrative Costs

Section 507(a)(1) of the Code provides that administrative expenses allowed under Section 503(b) of the Code are entitled to first priority in distribution of property of the estate. *See also* 11 U.S.C. § 726(a)(1). Such administrative expenses include virtually all costs of doing business incurred post-petition by the estate, including professional fees, the purchase of ordinary goods and services which are necessary and reasonable, and damages for any post-petition tort or breach of contract chargeable to the estate.

This treatment in bankruptcy reflects the congressional judgment that the costs of operating an estate should be borne by its unsecured creditors and shareholders. Although afforded a priority of distribution, 11 U.S.C. §§ 507(a)(2)-(7), 726(a)(2)-(6), such costs are *inferior* in priority to the claims of secured creditors. 11 U.S.C. §§ 507(b), 725; 3 *Collier on Bankruptcy* ¶ 507.02[2], at

507-16 (15th ed. 1986).[12] Secured creditors will not be made to bear a share of the estate's administrative costs unless they are shown to have received a specific, identifiable benefit. 11 U.S.C. § 506(c); *General Electric Credit Corp.* v. *Levin & Weintraub (In re Flagstaff Foodservice Corp.)*, 739 F.2d 73, 76 (2d Cir. 1984). Thus, contrary to the statement of the panel opinion that "all creditors generally share some of the risk in a reorganization proceeding," 793 F.2d at 1382, 1410-11, Congress plainly did not intend that the costs of operating an estate should be borne by secured creditors. *See also Reading Co.* v. *Brown*, 391 U.S. 471, 478 (1968). The illogical result of the decision below is to single out a particular type of cost of operating the debtor's estate—lost opportunity costs attributable to the delay in foreclosure and reinvestment of collateral proceeds—and impose only that particular cost on secured creditors.

D. Financing Debtors and the Use of Cash Collateral

The Code authorizes debtors to obtain credit. 11 U.S.C. § 364. Current interest rates are charged by post-petition lenders for the debtor's use of borrowed funds. Lenders which extend new credit after a bankruptcy proceeding has commenced are treated like other administrative claimants under Section 503(b); having provided a benefit to the estate in order to help the debtor continue in business, such lenders are entitled to appropriate post-petition compensation.

---

[12] Congress, in rejecting a proposal which would have permitted adequate protection to be provided by way of an administrative expense claim, noted that such an administrative claim "is too uncertain to be meaningful," thereby repudiating the form of adequate protection adopted in *In re Yale Express System, Inc.*, 384 F.2d 990 (2d Cir. 1967). Senate Report at 54. *See also* 124 Cong. Rec. H11,092 (Sept. 28, 1978) (remarks of Rep. Edwards) ("[I]n every case there is the uncertainty that the estate will have sufficient property to pay administrative expenses in full"). Clearly, Congress intended to provide greater protection to secured creditors than to administrative claimants, other priority claimants and unsecured creditors. *See also* 11 U.S.C. § 507(b). Congress' rejection of the *Yale Express* adequate protection alternative is significant, since it demonstrates an unwillingness to expose secured creditors to the risk of undercompensation. *See* Note, *Compensation for Time Value as Part of Adequate Protection During the Automatic Stay in Bankruptcy*, 50 U. CHI. L. REV. 305, 313-15 (1983).

A comparable arrangement for funding a business in bankruptcy is through the debtor's use of cash proceeds of collateral from either the sale of inventory or collection of accounts receivable in which a creditor has a security interest. Congress, in enacting the Code, prohibited a debtor from using such "cash collateral" over the lender's objection, unless the lender is provided with adequate protection. 11 U.S.C. §§ 363(c)(2), 363(e).

The debtor's use of cash collateral is analytically the same, in terms of benefit to the debtor and burden on the lender, as post-petition financing from an outside lender under Section 364. Thus, the debtor which seeks to use cash collateral for the continued operation of its business must repay that amount *with interest* in order to compensate the creditor for the interim loss of use of these funds. *See Martin* v. *United States (In re Martin)*, 761 F.2d 472, 475-78 (8th Cir. 1985); *In re Weyland*, 63 Bankr. 854, 861 (Bankr. E.D. Wisc. 1986); *In re EES Lambert Associates*, 62 Bankr. 328, 343-44 (Bankr. N.D. Ill. 1986); *In re Bear River Orchards*, 56 Bankr. 976, 978-79 (Bankr. E.D. Cal. 1986).

There is no economic difference between the secured creditor whose *cash* collateral is used without its consent and the secured creditor whose *non*-cash collateral is used without its consent. In each case, the benefit provided to the debtor is the same, and the secured creditor's entitlement to compensation for the time value of money should be the same. Because both Sections 362(d)(1) and 363(e) of the Code measure the scope of the adequate protection of such creditors' interests by the identical standards of Section 361, any inconsistency in treatment demonstrates that the decision below is not supportable.

E. Comparative Treatment of Undersecured Junior Lienors

The decision below implicitly draws an irrational and unsupported distinction between the protection to which a single undersecured lienor is entitled and the protection to which a junior lienor is entitled when there is an oversecured senior lien on the property. According to the Fifth Circuit, a single mortgagee with a claim of $150,000 secured by property worth $100,000 would be denied adequate protection of the present value of the mortgagee's right to foreclose and reinvest the $100,000 of collateral

value. However, if there were a $90,000 first mortgage and a $60,000 second mortgage on the property, the decision below would permit post-petition interest to accrue on the oversecured first mortgage, 11 U.S.C. § 506(c), which would decrease the equity available to protect the undersecured second mortgagee.

Under these circumstances, courts have consistently required the debtor to provide the junior undersecured mortgagee with compensation in the form of interest payments as adequate protection against the first mortgagee's accruing interest.[13] There is no rational basis to deny compensation for the time value of money in the one-lien case, as the decision below would dictate, while permitting it in the two-lien case.

F. The Solvent Debtor Anomaly

As noted by the panel opinion, 793 F.2d at 1386, unsecured creditors are entitled to post-petition interest on their claims when the estate is solvent, valued on a liquidation basis. *See* 11 U.S.C. §§ 726(a)(5), 1129(a)(7). Once this well-recognized and sensible rule is combined with the approach of the court below, however, only illogic results.

A recent district court decision, relying on the decision below, has declared that Congress did not intend "to backdoor post-petition interest payments to undersecured creditors as an element of adequate protection," even when the estate ultimately proves solvent. *Liberty Nat'l Bank & Trust Co. of Louisville* v. *George*, 70 Bankr. 312, 315-16 (W.D. Ky. 1987). To allow unsecured creditors to be paid in full and the balance of the estate to be returned to the debtor and its shareholders, while a secured creditor is denied full post-petition interest on its entire claim, is clearly wrong, and was recognized by the district court in *George* to be anomalous. The *George* court also recognized the anomaly of denying an undersecured creditor any post-petition interest on the *secured* portion of its claim while granting post-petition interest on the *unsecured* portion. 70 Bankr. at 315-16. The *George* court attributed these anomalies to a legislative oversight resulting in a "loophole from which debtors . . . will be able to benefit." *Id.* at 316. In reality, these incongruous results stem from a misapplication of Section 361 by the court below in denying undersecured creditors compensation for the delay caused by the automatic stay, and will be cured once the erroneous decision of the Fifth Circuit is reversed.

---

[13] *See, e.g., In re Polries Brothers*, 49 Bankr. 669, 674-75 (Bankr. D.N.D. 1985); *Ridgewood Savings Bank* v. *Houston (In re Houston)*, 32 Bankr. 584, 587 (Bankr. S.D.N.Y. 1983); *Central Trust Co.* v. *Bristol Mountain Enterprises, Inc. (In re Bristol Mountain Enterprises, Inc.)*, 13 Bankr. 412, 417 (Bankr. W.D.N.Y. 1981); *American Properties, Inc.* v. *Topeka Bank and Trust (In re American Properties, Inc.)*, 8 Bankr. 68, 71-72 (Bankr. D. Kan. 1980); *Kingsail Corp. of Marathon, Inc.* v. *Sombrero Beef Club, Inc. (In re Sombrero Reef Club, Inc.)*, 7 Bankr. 480, 482 (Bankr. S.D. Fla. 1980).

IV.

THE DECISION BELOW IS BASED ON A MISUNDERSTANDING OF THE HISTORY AND POLICY REGARDING THE TREATMENT OF POST-PETITION INTEREST IN BANKRUPTCY PROCEEDINGS

A. The Decision Below Is Based on Three Fundamental Misconceptions

In reaching its ultimate conclusion that undersecured creditors are not entitled, as part of adequate protection, to compensation for the loss of the right to foreclose on collateral and reinvest the proceeds, the court below labored under three fundamental misconceptions about the history and policy of the bankruptcy laws.

The first misconception is that before the adoption of the Code, it was "settled law" that foreclosure by undersecured creditors was stayed without compensation for lost opportunity costs. 793 F.2d at 1400-01. In fact, before the Code, such undersecured creditors generally were entitled to receive relief from the stay because the debtor, by definition, had no equity in the collateral. *See* discussion *supra* at 5. Thus, it is not surprising that the majority failed in its search for a clear expression of congressional intent to overrule existing law, *see, e.g.*, 793 F.2d at 1401, because there was no existing law which needed to be overruled.

The second misconception is that payment of lost opportunity costs to an undersecured creditor would involve an impermissible "reallocation of the unencumbered assets of an estate from unsecured to undersecured creditors." 793 F.2d at 1382; *see also id.* at 1408-10. The NCFA does advocate that an undersecured creditor should be compensated out of unencumbered assets for the economic loss it suffers by being unable to realize on its collateral due to its continued use by the debtor. But this compensation for use of property is no more an impermissible "reallocation" than similar payments from unencumbered assets to the many other entities that provide benefits to the estate post-petition—such as lessors, post-petition lenders, and other administrative claimants. *See* discussion *supra* at 17-20.

The third misconception, and perhaps the most pervasive, is the assumption that compensating undersecured creditors for the delay in exercise of their foreclosure rights is "simply post-petition interest payments in sheep's clothing," 793 F.2d at 1382 n.1, which, it is said, are inconsistent with the long-standing rules (now codified in Sections 502(b)(2) and 506(b) of the Code) that post-petition interest will generally not be allowed except to oversecured creditors. *See* 793 F.2d at 1381-82, 1385-89, 1413-14, 1415. For the reasons discussed below, this reasoning misapprehends the policies underlying the Code's general disallowance of post-petition interest, and ignores the special character of a secured creditor's rights in property which are to be safeguarded by the adequate protection requirements of Section 361.

B. Payment of Lost Opportunity Costs as Adequate Protection Is Consistent with the Policy and Historical Basis for the Principles Related to the Treatment of Interest in Bankruptcy

The general rule that interest which accrues after the filing of a bankruptcy petition will ordinarily not be allowed has its roots in early English law. 2 Blackstone, *Commentaries* 488 (1766). Its principal purpose, according to this Court, is "to assure equality among creditors as of the date of insolvency." *Ticonic National Bank* v. *Sprague*, 303 U.S. 406, 411 (1938).

The "equality" sought to be achieved by not permitting claims to include post-petition interest is based on several aspects of bankruptcy proceedings. Bankruptcy requires the equitable division among creditors of the limited assets of a debtor or their value, under circumstances that "the assets are generally insufficient to pay debts in full." *American Iron & Steel Manufacturing Co.* v. *Seaboard Air Line Railway*, 233 U.S. 261, 266 (1914). If all creditors' claims continued to accrue interest after bankruptcy—typically at different rates—some creditors' distributive shares would increase at the expense of others'. *Id.* Such a change in relative distributive rights was deemed inconsistent with the notion that "the creditors acquire a right *in rem* against the assets" as of the date of bankruptcy. *Sexton* v. *Dreyfus*, 219 U.S. 339, 345 (1911). It was also perceived to be unfair, because the delay in distribution which caused each creditor's proportionate share to change through accrual of interest was not by anyone's choice, but was "the act of the law . . . [and] a necessary incident to the settlement of the estate." *Thomas* v. *Western Car Co.*, 149 U.S. 95, 117 (1893); *American Iron, supra*, 233 U.S. at 266.[14]

Because the rule disallowing post-petition interest was based on the presumed "equality" of creditors, it was not applied when, as a result of certain creditors' unique rights, there was some basis for their preferential treatment. Most importantly, a secured creditor could collect post-petition interest to the extent of the value of its collateral, because that right was based on an interest in property which was different from the claims of other creditors, who were unsecured. *Ticonic, supra*, 303 U.S. at 411-13. *See also American Iron, supra*, 233 U.S. at 267 (authorizing payment of post-petition interest "on debts of the highest dignity"—a statutory priority claim—"even though what remains is not sufficient to pay claims of a lower rank in full"); *Sexton* v. *Dreyfus, supra*, 219 U.S. at 346 (undersecured creditor could collect post-petition interest to the extent of any "[i]nterest and dividends accrued upon some of [its collateral] after the date of the petition").

For two significant reasons, the principle of equality underlying the general rule disallowing post-petition interest does not preclude an award of lost opportunity costs as an element of adequate protection.

---

[14] An additional reason for the general rule disallowing post-petition interest was that computing claims as of the petition date was felt to avoid "administrative inconvenience" resulting from the continuous recomputation of claims, with accruing interest, each time a distribution or vote was to be made. *Vanston Bondholders Protective Committee* v. *Green*, 329 U.S. 156, 164 (1946). This factor has no relevance here.

First, to allow secured creditors their lost opportunity costs is hardly inequitable as to unsecured creditors. "[O]ur cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral." *Security Industrial Bank, supra*, 459 U.S. at 75. Any benefits which inure to secured creditors from the award of lost opportunity costs derive from the impairment of rights to realize on collateral which unsecured creditors simply do not possess. As this Court has recognized, there is a fundamental difference between a creditor's claim against the debtor, which historically is *in personam*, and a creditor's rights in collateral, which historically are *in rem*:

> Secured creditors have two sources of payment for their claims—the liability of the debtor and the liability of the pledged or mortgaged assets. One is personal, the other in rem. The liability in personam of the [debtor] gives rise to a claim in rem against the free assets in the hands of the receiver; the claim in rem against the security continues as a claim in rem against that same security. With respect to the former the secured creditors have merely the same rights as any general creditor, and in so far as dividends are paid to secured creditors from free assets, they share ratably with the unsecured creditors, and their claims bear interest to the same date, that of insolvency. *But to the extent that one debt is secured and another is not there is manifestly an inequality of rights between secured and unsecured creditors, which cannot be affected by the principle of equality of distribution, and interest accruing after insolvency may not be withheld on account of that principle.*

Ticonic, supra, 303 U.S. at 411-12 (emphasis added).

In short, the "equality of distribution" principle barring the allowance of post-petition interest applies only to claims that are in fact equal—and these are not. "[T]he position of a secured creditor, who has rights in specific property, differs fundamentally from that of an unsecured creditor, who has none. . . ." *Radford, supra*, 295 U.S. at 588. In fact, the decision below—which would require undersecured creditors alone to sacrifice property rights for the benefit of unsecured creditors, without compensation—would result in the very sort of inequity which the rule prohibiting the allowance of post-petition interest was designed to avoid.

Second, the policy underlying the general rule of protecting creditors from the inevitable delay of bankruptcy does not apply here, because the delay in exercise of secured creditors' foreclosure rights is not "attributable *solely* to the time consuming procedures inherent in the administration of the bankruptcy laws." *Nicholas* v. *United States*, 384 U.S. 678, 683-64 (1966) (emphasis added) (rule disallowing post-petition interest is not applicable where delay, although under court auspices, "did not arise through a 'delay' in the law in any meaningful sense"). Contrary to the statement of the court below, delay resulting from denial of relief from the stay is *not* "inherent in a bankruptcy proceeding." 793 F.2d at 1410. It results because the debtor makes a volitional decision to retain the secured creditor's collateral for the benefit of remaining creditors. This is a far cry from the "act of the law" requiring marshalling of assets and distribution to creditors which was the historical basis for the rule generally disallowing claims for post-petition interest.[15]

---

[15] The reliance of the decision below on *Sexton* and *Vanston*, 793 F.2d at 1385-86, 1413, is misplaced.

Sexton held that a secured creditor could not apply the proceeds of its security to interest first, and thereby indirectly expand its share of the estate's unencumbered assets by maintaining its principal claim. 219 U.S. at 344-45. The case did not deal with the rights of a secured creditor whose property was utilized by the estate without its consent. In fact, while *Sexton* is sometimes cited for the proposition that interest on secured as well as unsecured claims ceases upon the filing of the petition, this Court has limited its holding to cases "when the secured creditor, having realized upon his security, is seeking as a general creditor to prove for the deficiency against the bankrupt estate." *Radford, supra*, 295 U.S. at 597 n.30.

Vanston held that an oversecured creditor could not recover interest on interest. 329 U.S. at 165-67. Its rationale was that the failure to pay interest resulted from a court order prohibiting such payment, and that it would therefore be inequitable to exact an interest penalty in light of the "legal suspension of an obligation to pay." *Id.* at 166-67. Even assuming the continued viability of the *Vanston* holding, *see* Blum, *Treatment of Interest on Debtor Obligations in Reorganizations under the Bankruptcy Code*, 50 U. CHI. L. REV. 430, 436-38 (1983) (suggesting

(Footnote continued on following page)

C. The Code Provisions Dealing with Interest Do Not Preclude an Award of Lost Opportunity Costs as Part of Adequate Protection

Analysis of the Code's interest provisions yields the same conclusion as the above analysis of the history and policy of the general rule disallowing claims for post-petition interest—that they do not, expressly or implicitly, prevent undersecured creditors from receiving lost opportunity costs as adequate protection under Section 361.

The general rule prohibiting post-petition interest codified in Section 502(b)(2) is subject to a number of statutory and judicial exceptions;[16] the right of an undersecured creditor to receive compensation for lost opportunity costs is just one more example. Sections 502(b)(2) and 506(b) are irrevelant to the scope of adequate protection under Section 361, which is based on different statutory language, measures a different right, uses different methods of computation, and involves significantly different procedures from those relating to the allowance or disallowance of interest on claims.

(Footnote continued from previous page)

Vanston was undermined by § 1124 of the Code), it does not apply to this case, where the debtor is making a voluntary decision to oppose relief from the stay. *Cf. In re Int'l Hydro-Electric System*, 101 F. Supp. 222, 224-25 (D. Mass. 1951) (*Vanston* inapplicable where delay in payment of interest was due to choice of the trustee).

[16] These include: (i) oversecured creditors are entitled to post-petition interest under § 506(b); (ii) unsecured creditors will receive interest if the estate is solvent, *see* §§ 726(a)(5) (payment of post-petition interest in Chapter 7 liquidation cases), 1129(a)(7) (assurance to dissenting creditors in Chapter 11 case that they will receive no less than they would have received in a Chapter 7 liquidation); (iii) debtors are not prohibited from paying post-petition interest to cure defaults pursuant to the exercise of the option provided by § 1124(2) to reinstate the maturity of a previously accelerated debt; and (iv) secured creditors are entitled to recover interest from income generated post-petition by their collateral, *see Sexton* v. *Dreyfus, supra*, 219 U.S. at 346. *See also In re Village Properties, Ltd.*, 723 F.2d 441, 446-47 (5th Cir. 1984) (secured creditor may, pursuant to §§ 546(b) and 552(b), file notice of perfection of its interest in rents, issues and profits generated post-petition from its collateral).

Interest provisions of the Code deal with amounts allowable on claims. As noted above, however, the right of a secured creditor to adequate protection is derived from its property rights under state law with respect to its collateral which the automatic stay prevents it from exercising, not from the nature of its claim. *See Ticonic, supra,* 303 U.S. at 411-12. *See* discussion *supra* at 23-25.

Because different rights are involved, adequate protection is computed in a very different manner from that used to calculate the interest payable to an oversecured creditor. Interest, commencing from the petition date, is allowed to the oversecured creditor on the full amount of its debt at the contract rate. 11 U.S.C. § 506(b). Adequate protection, by contrast, is not based on the amount of outstanding debt or the contract rate of interest, but on the amount the undersecured creditor would have earned by foreclosing on its collateral and reinvesting the proceeds. See Jackson Amicus Brief at 27-28 & n.28.

Finally, Section 506(b) is defined so as to be self-executing; it affords an "automatic safe harbor" to the oversecured creditor by assuring that it will recover interest and costs to the extent of the value of its collateral. Jackson Amicus Brief at 27-28. There is nothing automatic about whether the undersecured creditor seeks relief from stay to obtain adequate protection under Section 361.

Thus, while adequate protection payments might, in certain circumstances, be measured by a rate of return on reinvested assets from proceeds of collateral, that does not mean that such payments are interest. The decision below confuses the conceptual nature of the right to lost opportunity costs with the index by which the value of that right is measured. While the value of the right to foreclose and reinvest the proceeds is most often *measured* by the interest which the secured creditor could earn on such proceeds in the market, this does not transmute the essential *nature* of the compensation from rent to interest. *See Phelps* v. *United States,* 274 U.S. 341, 343-44 (1927) (where use of private

property is taken by eminent domain, increase in payment to compensate for delay, although measured by a reasonable rate of interest, is nonetheless "not a claim for interest within the purpose or intention of [Section 177 of the Judicial Code]"). As Petitioner notes, compensation for the delay in exercise of foreclosure rights more closely resembles rent than interest, since it is based on the debtor's continued use and occupancy of property in which the creditor holds a security interest. Petitioner's Brief at 36-38. It is no more interest than rent under a lease which is calculated based on a formula dependent on the prime rate of interest.

CONCLUSION

For the foregoing reasons, the NCFA asks this Court to reverse the decision of the Court of Appeals for the Fifth Circuit below, and remand the cause for proceedings consistent with such reversal.

Respectfully submitted,

A. Bruce Schimberg*
Rex E. Lee
J. Ronald Trost
Shalom L. Kohn
Joel G. Samuels
Sidley & Austin
One First National Plaza
Chicago, Illinois 60603
(312) 853-7000

Attorneys for Amicus Curiae
National Commercial Finance
Association

Of Counsel:

Frank R. Kennedy
Professor Emeritus
University of Michigan
Law School
Counsel, Sidley & Austin

*Counsel of Record

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
FILED
AUG 31 1987
JOSEPH F. SPANIOL, JR.
CLERK

NO. 86-1602 ⑨

IN THE
Supreme Court of the United States
October Term, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent

WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF AMICUS CURIAE

Raymond T. Nimmer
University of Michigan
School of Law
Ann Arbor, Michigan 48109
(313) 764-1358

Edward L. Ripley
3700 First City Tower
Houston, Texas 77002
(713) 658-8881

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

42pp

SUBJECT INDEX

Page

INTEREST OF AMICUS CURIAE 1

SUMMARY OF ARGUMENT 1

ARGUMENT 2

I. AN UNDERSECURED CREDITOR IS NOT ENTITLED, AS A MATTER OF LAW, TO RECEIVE INTEREST PAYMENTS TO COMPENSATE FOR DELAY IN ENFORCING ITS FORECLOSURE RIGHTS 2

A. AWARDING OF POSTPETITION INTEREST IS CONTRARY TO THE EXPLICIT PROVISIONS OF BANKRUPTCY CODE SECTIONS 502 AND 506 4

B. REQUIRING POSTPETITION PAYMENTS TO UNSECURED CREDITORS ELEVATES CODE SECTION 361(3) TO THE EXCLUSION OF SECTIONS 361(1) AND (2) 6

C. THE LEGISLATIVE HISTORY OF THE BANKRUPTCY CODE DOES NOT INDICATE THAT UNDERSECURED CREDITORS ARE ENTITLED TO RECEIVE INTEREST FOR DELAY IN FORECLOSURE 8

II. REQUIRING DEBTORS TO COMPENSATE UNDERSECURED CREDITORS IN ALL CASES FOR MERE DELAY IS AN INAPPROPRIATE ALLOCATION OF LOSS IN BANKRUPTCY 9

A. REQUIRING POSTPETITION INTEREST IN ALL CASES TAKES PROPERTY FROM UNSECURED CREDITORS AND THE DEBTOR WITHOUT STATUTORY AUTHORIZATION .. 10

B. REQUIRING POSTPETITION INTEREST OVERCOMPENSATES THE UNDERSECURED CREDITOR WHENEVER THE REORGANIZATION INCREASES THE VALUE OF THE COLLATERAL 12

Page

C. REQUIRED COMPENSATION FOR POSTPETITION INTEREST FORCES EARLY DECISIONS THAT MAY RESOLVE THE ULTIMATE RIGHTS OF THE PARTIES WITHOUT THE SUBSTANTIVE AND PROCEDURAL PROTECTION AVAILABLE IN CONFIRMATION OF A PLAN 14

D. ADEQUATE PROTECTION REQUIRES PROTECTION FOR DEPRECIATION, BUT NOT MERE DELAY 16

III. MANDATORY INTEREST PAYMENTS ARE NOT REQUIRED BY PRIOR DECISIONS OF THIS COURT 17

A. THE DECISION IN *BUTNER V. UNITED STATES* DOES NOT SUPPORT THE PAYMENT OF POSTPETITION INTEREST TO UNDERSECURED CREDITORS IN ALL CASES 17

B. *IN RE MUREL HOLDING CORPORATION*, DOES NOT JUSTIFY REQUIRING THE PAYMENT OF INTEREST IN ALL CASES 19

IV. UNDER SECTIONS 361 AND 362, BANKRUPTCY COURTS HAVE THE RIGHT, BUT NOT THE OBLIGATION TO REQUIRE PAYMENTS OR OTHER TRANSFERS IN EXCESS OF DEPRECIATION AS COMPENSATION FOR DELAY AND FOR RISK 20

CONCLUSION 23

APPENDIX A. CONSENT TO FILING OF AMICUS CURIAE BRIEF 1a

TABLE OF AUTHORITIES

CASES

Page

In re Ahlers, 794 F.2d 388 (8th Cir. 1986) 15
In re American Mariner Industries, Inc., 734 F.2d 426 (9th Cir. 1984) 3
In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983) 15
In re Briggs Transportation Co., 780 F.2d 1339 (8th Cir. 1985) 3, 21, 22
Butner v. United States, 440 U.S. 48 (1978) 11, 17, 18
Caminetti v. United States, 242 U.S. 470 (1917) 6
Case v. Los Angeles Lumber Products Co., 308 U.S. 106 (1939) 15
In re Continental Airlines, 780 F.2d 1223 (5th Cir. 1983) 15
In re Murel Holding Corporation, 75 F.2d 941 (2d Cir. 1935) 19, 21
Nicholas v. United States, 384 U.S. 678 (1966) 11
In re Timbers of Inwood Forest, 793 F.2d 1380 (5th Cir. 1986), *aff'd en banc*, 808 F.2d 360 (1987) 4, 9, 19
United States v. Universal C.I.T. Credit Corp., 344 U.S. 218 (1952) 5, 6
Vanston Bondholders Protection Committee v. Green, 329 U.S. 156 (1946) 11
Matter of Village Properties, Ltd., 723 F.2d 744 (5th Cir. 1984) 18

STATUTES

11 U.S.C. § 361 (1987) 3, 5, 6, 7, 8, 21
11 U.S.C. § 362 (1987) 2, 3, 5
11 U.S.C. § 502 (1987) 4, 5, 11
11 U.S.C. § 506 (1987) 4, 5, 6, 7, 10, 12, 13
11 U.S.C. § 1111 (1987) 10
11 U.S.C. § 1129 (1987) 8, 13, 14
11 U.S.C. § 1325 (1987) 8

OTHER AUTHORITIES

H. Rep. No. 595, 95th Cong., 1st Sess., 220 (1977) 2
Nimmer, Secured Creditors and the Automatic Stay: Variable Bargain Models of Fairness, 69 Minn. L. Rev. 1 (1983) 6, 16, 20
124 Cong. Rec. H 11,095 (Sept. 28, 1978); S. 17,411 (Oct. 6, 1978) 14, 17
S. Rep. No. 989, 95th Cong. 2d Sess. 54 (1978) 16

INTEREST OF AMICUS CURIAE

The Amicus have no financial interest in this matter and submit this Amicus Curiae Brief solely for academic reasons of promoting an appropriate development of the law in this field.

Raymond Nimmer is a Visiting Professor of Law at the University of Michigan Law School and Counsel to the law firm of Sheinfeld, Maley & Kay, a Houston law firm specializing in bankruptcy law. Edward Ripley is an Associate at the Sheinfeld firm. They have extensive involvement in bankruptcy law practice and in the study of the field.

Amicae have a professional interest in the fair and effective administration of bankruptcy law. Their concern is that this Court's judgment be reached after a full and fair consideration of all issues raised on this appeal and that the imbalance of economics between the creditor and debtor in a bankruptcy case not limit the presentation necessary to this result.

SUMMARY OF ARGUMENT

Neither the language of the Bankruptcy Code, its legislative history, nor the policies underlying bankruptcy law support a requirement that in all cases an undersecured creditor receive interest on its claim as a form of "adequate protection" prior to the confirmation of a reorganization plan. If imposed in all cases, such interest often overcompensates the creditor, taking property from unsecured creditors without statutory authorization. "Adequate protection" under 11 U.S.C. §§ 361 and 362(d) was intended to be a flexible standard giving trial courts discretion to tailor the remedy to the particular case. This Court should reaffirm this Congressional intent and reject rules that either require interest payments in all cases, or that entirely prohibit them. Instead, this Court should adopt an interpretation of "adequate protection" that permits a bankruptcy court to determine whether or not to require interest payments on a case by case basis.

ARGUMENT

I.

AN UNSECURED CREDITOR IS NOT ENTITLED, AS A MATTER OF LAW, TO RECEIVE INTEREST PAYMENTS TO COMPENSATE FOR DELAY IN ENFORCING ITS FORECLOSURE RIGHTS

Neither the Bankruptcy Code nor its legislative history indicates that Congress intended that all undersecured creditors receive compensation for lost opportunity or interest on their secured debt. Furthermore, a requirement that such compensation be paid effectuates wrong policy and distributes loss in an uneven manner inconsistent with bankruptcy goals. Instead, in "adequate protection", Congress provided courts a method to equitably adjust risk during the period prior to conclusion of a bankruptcy case. "[T]here are an infinite number of variations in dealings between debtors and creditors . . . flexibility is important to permit courts to adapt to varying circumstances. . . ." H.Rep. No. 595, 95th Cong., 1st Sess. 220 (1977).

Under 11 U.S.C. § 362(a), on the filing of a bankruptcy petition, a secured creditor's right to foreclose is restricted by an automatic stay. The stay continues in effect until the case closes or the Court grants relief. 11 U.S.C. § 362(a), (d). One standard for granting relief from the stay is for "cause, including a lack of adequate protection" of the creditor's interest in property, 11 U.S.C. § 362(d)(1). The Bankruptcy Code provides that adequate protection can be given in various ways including, but not limited to, periodic payments to the extent that the value of the interest declines, replacement liens to the extent of declining value, or such other means as well as give the creditor the "indubitable equivalent" of its interest. 11 U.S.C. § 361.

The concept of "adequate protection" serves as the fulcrum on which the rights of secured creditors, unsecured creditors and the debtor are balanced prior to completion of a reorganization plan. This Court's decision will resolve the conflicting opinions of several numerous lower courts on whether, as adequate protection, an undersecured creditor is entitled in all cases to interest payments (termed "lost opportunity costs") to compensate for delay in foreclosure.

The lower courts that mandate interest payments argue that the required interest payments comply with language in 11 U.S.C. § 361(3) permitting courts to give protection by requiring that a creditor receive the "indubitable equivalent" of its claim and statements in the legislative history referring to secured creditors receiving the "benefit of their bargain". *See, In re American Mariner Industries, Inc.*, 734 F.2d 426 (9th Cir. 1984) (hereinafter referred to as "*American Mariner*").

Other courts adopt a position that interest payments to an undersecured creditor are not required, but may be ordered depending upon the facts and circumstances of the particular case. *See, In re Briggs Transportation Co.*, 780 F.2d 1339 (8th Cir. 1985) (hereinafter referred to as "*Briggs*"). These decisions focus on the flexibility of adequate protection that is emphasized in the legislative history of the Bankruptcy Code and the fact that "indubitable equivalent" is only one option in giving a creditor protection of its property interest.

The Fifth Circuit Court of Appeals' decision in this case adopts a third view. It holds that an undersecured creditor cannot receive interest payments to compensate for lost opportunity costs. *See, In re Timbers of Inwood Forest,* 793 F.2d 1380 (5th Cir. 1986), *aff'd en banc* 808 F.2d 360 (1987) (hereinafter referred to as "*Timbers*").

We argue that this Court should reject both the *American Mariner* and the *Timbers* rules and adopt the *Briggs* view that permits flexibility of decision for the lower courts based on the facts of individual cases. The *American Mariner* decision misreads the Bankruptcy Code and its legislative history. *Timbers* precludes trial courts from exercising the discretion intended by Congress. A position consistent with the Circuit Court decision in *Briggs* fosters both that Congressional intent and the plain meaning of the Code.

A. Awarding of Postpetition Interest is Contrary to the Explicit Provisions of Bankruptcy Code §§ 502 and 506.

11 U.S.C. § 502(a) provides that no claim for interest is allowed in bankruptcy if the interest is not matured at the time of the petition. 11 U.S.C. § 506(a) provides that, in determining an allowed "secured claim" the court must compare the "value" of the collateral to the outstanding debt owed on the petition date. If the collateral value is greater than the amount of the debt, the creditor is oversecured and its claim is equal to its debt. If the value is less than the amount of the debt, the creditor is undersecured and its secured claim is limited to the value of the property.

Bankruptcy Code § 506(b) permits an oversecured creditor to recover, "interest on [its] claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." This is an express exception to the general rule of Section 502. The creditor, however, is entitled to such interest and costs only up to the value of the collateral. Section 506 (b) is the *only* provision in the Code which authorizes the payment of postpetition interest. To be entitled to receive postpetition interest, the creditor must be *oversecured.*

There is no corresponding provision for unsecured or undersecured creditors. Despite this, the *American Mariner* rule requires interest payments to undersecured creditors. This is contrary to the explicit provisions set forth in § 506(b). The Bankruptcy Code embodies concepts of equity as well as legislative compromises. The Bankruptcy Code must be viewed as a whole and isolated portions cannot be excised and read out of context. *See, United States v. Universal C.I.T. Credit Corp.,* 344 U.S. 218 (1952). Sections 361 and 362 cannot be read to require a result that is explicitly prohibited by Section 506(b).

An arguably ambiguous statutory provision cannot be interpreted to undermine clear and unambiguous provisions. Nevertheless, some have suggested that Section 506(b) does not preclude paying interest on undersecured claims since, while Section 506(b) applies in all cases, "adequate protection" applies only if requested by the creditor. This places form over substance. A rule requiring interest as adequate protection exactly contradicts Section 506(b). The intended and actual effect is that all undersecured creditors will demand and receive interest even though Section 506(b) permits this result only if the creditor is oversecured.

B. Requiring Postpetition Payments to Unsecured Creditors Elevates Code Section 361(3) to the Exclusion of Sections 361(1) and (2).

Requiring postpetition interest payments to unsecured creditors is inconsistent with normal statutory construction that courts must apply the plain language of a statute and read the statute in its entirety. *United States v. Universal C.I.T. Credit Corp.*, 344 U.S. 218 (1952); *Caminetti v. United States*, 242 U.S. 470 (1917). Section 361 sets out non-exhaustive examples of how adequate protection can be given to a creditor. The first two subsections are quite plain. Subpart (1) provides that a debtor can make periodic cash payments when the debtor's use of the creditor's collateral "results in a decrease in the value of such entity's interest in such property." 11 U.S.C. § 361(1) There is no disagreement that adequate protection requires the payment or other compensation if the debtor's use of the collateral decreases the recoverable value of the property. See Nimmer, *Secured Creditors and The Automatic Stay: Variable Bargain Models of Fairness*, 69 Minn. L. Rev. 1 (1983).

Section 361(2) indicates that the debtor can grant an additional or replacement lien to the extent that the use of property "results in a decrease in the value of such entity's interest in such property." 11 U.S.C. § 361 (2). Again, this compensates the creditor for a decrease in recoverable value. The risk protected against here is

depreciation or loss of the property. If the debtor uses a dollar of inventory on which the secured creditor holds a lien, the debtor must provide a dollar's worth of replacement inventory.

Subsection (3), on its face, merely gives flexibility to the bankruptcy courts in providing adequate protection. It permits "granting such other relief" as will result in the creditor's receiving the indubitable equivalent of its interest. By its terms, the statute makes this merely one optional form of protection. The *American Mariner* decision, however, turns Section 361 upside down by mandating that bankruptcy courts require the indubitable equivalent and that debtors pay postpetition interest to undersecured creditors for "lost opportunity costs" as well as payments or liens for a decrease in value. This effectively eliminates and subordinates subparts (1) and (2) as the means of adequate protection.

A statute must be read as a whole to give effect to all of its parts. *American Mariner* elevates subpart (3), the general catchall provision, over subparts (1) and (2) and creates a result in which these other provisions will either never apply or be ignored. There is no legislative history to support this interpretation. In fact, *American Mariner* flies in the face of normal statutory construction.

To circumvent this obvious flaw, some will argue that the word "value" in Section 361(1) and (2) implicitly requires payment of interest to preserve the hypothetical "present value" of the secured claim. This is unsupported by the statute or the legislative history of the Code. The phrase "value of the entity's interest" used in Section 361 is also used in Section 506(a) and (b), but clearly does not include interest or "present value" in that context. In sections 1129 and 1325, the term is used again. When interest or present value is required, however, Congress in those provisions explicitly so provided by specifying that required payments have a value as of the effective date of a plan. Silence in Section 361 indicates that the value protected is the saleable or recoverable value, not a present value equivalent.

C. The Legislative History of the Bankruptcy Code Does Not Indicate That Undersecured Creditors are Entitled to Receive Interest for the Delay in Foreclosure.

In interpreting a statute, a Court should be guided by Congressional intent and the plain meaning of the statute. Courts supporting the *American Mariner* position attempt to justify their position by focusing on small phrases in the legislative history and on strained readings of the express terms of the Code.

A review of the legislative history in *toto*, however, does not support the *American Mariner* result. In the panel decision in *Timbers*, Circuit Judge Randall conducted an exhaustive review of the legislative history of Sections 361 and 362, discussing the cases under the Bankruptcy Act, the criticism of the pre-Bankruptcy Code's automatic stay provisions, the history of the Bankruptcy Reform Act including the Commission proposals, the Committee hearings and Committee reports. See *Timbers*, 793 F.2d at 1390-1401. Nowhere in the legislative history is there an indication that Congress intended to require or even considered requiring postpetition interest payments to compensate for "lost opportunity costs."

When reviewing the legislative history as a whole, as the panel decision in *Timbers* indicated:

> the simple fact is that in thirty-five days of in-depth hearings before the House sub-committee resulting in over 2,700 pages of testimony from more than 100 witnesses, as well as in Senate hearings that were nearly as extensive, the subject of periodic postpetition interest payments for undersecured creditors was not raised in the testimony or prepared statement of a single witness. Not one of the many witnesses for secured creditors even mentioned the award of postpetition interest payments or sought compensation for the delay required by the stay. *Timbers*, 793 F.2d at 1395, 1396.

As a matter of law and statutory construction, after the express terms of the statute, the legislative history is the most important basis for judicial interpretation of congressional intent. Here, there is no indication that Congress even discussed lost opportunity costs, let alone that postpetition interest payments are required, as a matter of law. In its deliberations, Congress refers to protecting the secured creditor's "bargain". The bargain referred to relates to the creditor's right ultimately to receive the recoverable value of its collateral. It does not incorporate a purported right to receive interest as a form of compensation for delay.

II.

REQUIRING DEBTORS TO COMPENSATE UNDERSECURED CREDITORS IN ALL CASES FOR MERE DELAY IS AN INAPROPRIATE ALLOCATION OF LOSS IN BANKRUPTCY

A rule requiring post petition interest is a rule of loss allocation that does not merely compensate a creditor for the "cost" of delay. The mandatory interest payment shifts loss away from a creditor, increasing losses for unsecured creditors and for the debtor. This shift is not justified by the undersecured creditor's mere claim to its collateral.

A. Requiring Post Petition Interest In All Cases Takes Property from Unsecured Creditors and the Debtor Without Statutory Authorization.

A debtor's bankruptcy creates an estate administered for the benefit of creditors and other parties. The secured creditor has a priority right to the value of its collateral (its "secured claim"), but has no special claim to any other property of the estate. 11 U.S.C. § 506. The secured claim is the value of the creditor's "interest" in the property and is measured by what the creditor would recover if the collateral were sold. For an undersecured creditor, the Bankruptcy Code separates the claim into secured and unsecured portions. The unsecured claim is coequal with other unsecured claims, with very limited exceptions. *See* 11 U.S.C. 1111(b).

Property other than a secured creditor's collateral is a fund from which unsecured creditors and the debtor are paid. In practice, however, any compensation given to an undersecured creditor for delay must be taken from this unencumbered property. There is no other source, whether the transfers involve payments in cash or the creation of a lien.

A rule requiring payment of interest indirectly gives the undersecured creditor a superior claim to assets other than its own collateral. It takes these assets from the pool available for unsecured creditors, giving them to the secured party. This superior claim, if created, is purely

a federal court rule. It does not exist under state contract or property law.

This Court has held that federal law does not create additional property rights beyond those that exist under state law unless there is a clear legislative mandate that this occur. *Butner v. United States*, 440 U.S. 48 (1978). Requiring compensation from unencumbered property in all cases creates an enhanced property interest without statutory authorization. If the secured creditor desired a superior claim to unencumbered property, state law provides ample means to achieve this before bankruptcy. The result should not be imposed under the guise of adequate protection where the parties did not previously contract for this right.

The dissent in the *en banc* decision in this case likens interest payments to the costs of administration, but this categorization is a clear error. Administrative costs are expenditures that benefit the estate as a whole, rather than payments to one creditor who is preferred over the other creditors of the bankrupt. They commonly include employee salaries, trustee fees, attorney fees, and similar expenses of the reorganization. 11 U.S.C. § 502. These expenditures do not allocate loss among parties with prepetition claims. Paying interest, on the other hand, does allocate loss. It takes property from some creditors (without consent) to benefit others (who otherwise have no claim to this property). This result is inconsistent with this Court's interpretation of prior bankruptcy statutes and is inconsistent with the current Code. *Nicholas v. United States*, 384 U.S. 678 (1966); *Vanston Bondholders Protection Committee v. Green*, 329 U.S. 156 (1946).

Under bankruptcy law, furthermore, administrative costs associated with a secured creditor's collateral are assessed against the secured creditor; they are not taken from the unsecured creditors. The dissent in *Timbers* ignores 11 U.S.C. § 506(c) which expressly requires that the cost of preserving the collateral of a secured creditor be charged to that creditor, not to the unsecured creditors in the case to the extent these expenses benefit the secured claim. 11 U.S.C. § 506(c).

The unsecured creditors and the debtor are not required to protect the sceured party from *all* risk. They do not guaranty that the secured lender, alone among other claimants, will suffer no harm or inconvenience as a result of the debtor's bankruptcy.

B. Requiring Postpetition Interest Overcompensates the Undersecured Whenever the Reorganization Increases the Value of the Collateral.

It is said that the secured creditor does not benefit from a reorganization and that, unless it receives interest or other compensation for delay, its collateral is being used solely to benefit other parties. This makes a comfortable argument, but misrepresents existing law and practice. Requiring interest in all cases will often pay the undersecured creditor for a delay that may substantially benefit it, resulting in double compensation.

This overcompensation is clear if we assume a secured creditor with a debt of $10,000 and collateral worth $3,000 if the reorganization does not occur and $9,000 if reorganization succeeds. If this creditor must receive interest on its $3,000 as compensation for mere delay, the money it receives is taken from the unsecured creditors. If reorganization succeeds and increases the value of the collateral, however, the secured creditor receives

the benefit of this increase. At the conclusion of the case, the creditor has received both compensation for delay and its increased secured claim of $9,000. None of the benefit goes to the creditors who paid the cost.

There is no sustainable reason for requiring other creditors and the debtor to compensate an undersecured creditor who receives the benefit of reorganization. It is simply wrong to say that the udersecured creditor does not benefit from a reorganization. If interest is required in all cases, the creditor will often be paid for "permitting" a delay that benefits it as much or more than those who are required to pay for the opportunity.

This double compensation exceeds even what an *over*secured creditor would receive. The oversecured creditor can never receive more in total than the value of its collateral ($9,000). 11 U.S.C. § 506(b). Interest at the contract rate accumulates only up to that value. A rule that gives better treatment to undersecured creditors than to creditors who enter the bankruptcy proceeding with a more advantageous collateral position simply perverts the idea of adequate protection and § 506(b).

One could argue that the creditor's secured claim should be fixed at the time adequate protection is given. Certainly, this is consistent with a view that the creditor should be compensated for a delay in recovering its "claim". This result requires, however, that confirmation law in Chapter 11 be ignored or rewritten. It simply cannot be sustained under current law.

11 U.S.C. § 1129(b) entitles the secured claimant to the present value of its secured claim "as of the effective date of the plan". 11 U.S.C. § 506(a) requires that secured claims be valued in light of the purposes of the

valuation, expressly allowing variations in value and, hence, in the secured claim over time. "[D]eterminations for purposes of adequate protection [are] not binding for purposes of . . . confirmation in a case under chapter 11." 124 Cong. Rec. H 11,095 (Sept. 28, 1978); S 17,411 (Oct. 6, 1978).

The secured claim for purposes of confirmation is measured at the completion of the case and includes the enhanced value created by reorganization. To suggest that this Court alter that rule in order to sustain a requirement of post petition interest is to suggest that the cart lead the horse and that this Court write a law that Congress chose not to enact.

C. Required Compensation for Post Petition Interest Forces Early Decisions that May Resolve the Ultimate Rights of the Parties Without the Substantive and Procedural Protections Available in Confirmation of a Plan.

The automatic stay gives a debtor an opportunity to review and restructure its operations and debts. It holds creditors at bay while the debtor undertakes such restructuring. Requiring compensation for interest in all cases, however, will often frustrate this objective before the debtor has even an opportunity to begin. Such a rule prematurely closes potentially successful businesses. It creates this result in a setting that is not suited to full consideration of all claims.

Interest or its equivalent is required for secured claims under confirmation standards in 11 U.S.C. 1129(b), but this fact exemplifies why a similar, universal requirement should not be imposed in the automatic stay. Standards for confirmation of a reorganization plan under 11 U.S.C. 1129 require that a court consider the interests of all affected parties. By voting for or objecting to the plan, all creditors have immediate influence on the terms. Furthermore, the court receives detailed information about how the debtor proposes to reorganize and whether that proposal is feasible. While a secured creditor has a right to interest in a plan, unsecured creditors have a right to full payment if the debtor retains his equity in the business. But see, *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939); *In re Ahlers*, 794 F.2d 388 (8th Cir. 1986).

The contrast between this setting and automatic stay litigation could not be more complete. Adequate protection issues are often resolved very early, long before a plan has been or could be proposed. Only two parties are represented (the debtor and the secured creditor). While the other parties receive notice, they do not receive the full disclosure that precedes a reorganization plan. A court simply cannot fully consider or even understand their interests.

Several Courts of Appeal have restricted how far a Bankruptcy Court or the parties can go in resolving the details of a reorganization outside the consideration of confirming such plan. They restrict this because the sale of assets or automatic stay litigation lacks the procedural and substantive safeguards present in confirmation hearings. See *In re Continental Airlines*, 780 F.2d 1223 (5th Cir. 1983); *In re Braniff Airways, Inc.*, 700 F.2d 935 (5th Cir. 1983).

Requiring compensation for delay will terminate a case without the opportunity for reorganization whenever the unencumbered property of the debtor at the time of *filing* is not immediately adequate to give compensation, but the secured creditor nevertheless demands "adequate protection". The Bankruptcy Court in such cases must have the discretion and flexibility to balance all of the interests involved. It loses this discretion if it is required to order immediate compensation even though there may be no property to transfer.

D. Adequate Protection Requires Protection for Depreciation, But Not for Mere Delay.

The clear implication of 11 U.S.C. 361(1) and (2) is that adequate protection permits cash payments and replacement liens to compensate for depreciation in the recoverable value of the collateral. S. Rep. No. 989, 95th Cong. 2d Sess. 54 (1978) ("The periodic payments would . . . compensate for the depreciation . . .").

Compensation to avoid loss due to depreciation is a "core" protection in adequate protection litigation. Courts require this protection in virtually all cases and this result may be justified by the express statutory language and legislative history of the Code. Nimmer, *Secured Creditors and the Automatic Stay: Variable Bargain Models of Fairness,* 69 Minn. L. Rev. 1, 14-16 (1983).

Both depreciation and delay in payment may cause economic harm to a secured creditor, but while both may adversely affect the economic interests of the undersecured creditor treating the two harms differently is consistent and rational. Mandating protection against depreciation losses, but not for mere delay represents a balance, and is one way of adjusting the interests of the secured lender against those of other parties in the case.

Unlike lost investment opportunity, depreciation losses are tangible and measurable. This concreteness is one reason for treating them differently. Determining the amount of opportunity loss requires assumptions about when the collateral would have been liquidated, and when cash would have been obtained and what would have been done with it. It assumes that the creditor would make an investment that never occurred and that this investment would produce an actual return without further loss. All assumptions may or may not be true. Depreciation, in contrast, can be determined by intermittent appraisals and eventual sale of the property. It represents the more observable and, potentially, confinable loss.

As one sponsor of the final version of the Bankruptcy Code indicated, the purpose of adequate protection is to "protect a creditor's allowed secured claim". 124 Cong. Rec.—(1978) (remarks of Congressman Edwards). That is, the objective is to protect against a deterioration of the value that can be recovered in a sale of the collateral. Leaving other potential forms of loss unprotected is simply a product of a reasoned balancing or allocation process.

III.

MANDATORY INTEREST PAYMENTS ARE NOT REQUIRED BY PRIOR DECISIONS OF THIS COURT

A. The Decision in *Butner v. United States* Does *Not* Support the Payment of Postpetition Interest to Undersecured Creditors In All Cases.

Some commentators indicate that a basis for *American Mariner* can be found in this Court's decision in *Butner v. United States,* 440 U.S. 48 (1979). *Butner* clearly does not support *American Mariner* and, in fact, has been miscited in this regard.

The issue in *Butner* was whether federal law or state law would determine whether a creditor's security interest attached to certain proceeds, rents and revenues. As Justice Stevens writing for the Supreme Court indicated, the real dispute between the bankruptcy trustee and the second mortgagee was "whether the right ~~to~~ such rents is determined by a federal rule of equity or by the law of the state where the property is located." *Butner v. United States,* 440 U.S. at 49. The rule in *Butner* is that ambiguous Bankruptcy Code provisions do not create an interest in property where no such interest exists under state law.

The *Butner* decision and rationale does not support *American Mariner*. *Butner* stands for the proposition that the determination of whether a creditor is secured or unsecured as to particular property is governed by state law. State law has always been the most important basis to determine the rights of secured creditors and the scope of a security interest. *See also, Matter of Village Properties, Ltd.,* 723 F.2d 744 (5th Cir. 1984).

To take this simple proposition and transform it to a proposition that the Bankruptcy Code may not suspend creditor rights is completely contrary to that case. *Butner* is miscited. Postpetition interest is not required as a matter of law. In fact, requiring such payment in bankruptcy gives a secured creditor a priority right to unencumbered property. Using an arguably ambiguous bankruptcy provision to create such a right is contrary to *Butner*. There is nothing in the Bankruptcy Code or legislative history that turns the *Butner* proposition into one which requires, as a matter of law, the payment of postpetition interest to an undersecured creditor.

B. *In Re Murel Holding Corporation*, Does Not Justify Requiring the Payment of Interest In All Cases.

The examples of adequate protection set forth in § 361 are fairly clear and plain except for subpart (3) when it includes the phrase "indubitable equivalent". This phrase is the basis for the dispute as to whether the *American Mariner* position of requiring postpetition interest payments to undersecured creditors is appropriate.

The phrase "indubitable equivalent" was included in Section 361 in the examples of adequate protection as a legislative compromise. *See, Timbers of Inwood Forest,* 793 F.2d at 1398, 1399. The phrase "indubitable equivalent" comes from Judge Learned Hand's opinion in *In Re Murel Holding Corporation,* 75 F.2d 941 (2nd Cir. 1935). *Murel* involved an entirely different context. It dealt with confirmation of a reorganization plan compared with the temporary suspension of some secured creditor rights due to the automatic stay.

The debtors in *In Re Murel Holding Corporation* set forth a plan of rearrangement in which the mortgagee was to receive interest on an accrued basis in addition to principal. The *Murel* Court held that the plan before it was not confirmable even though it provided for the payment of interest. Interest was an insufficient "adequate protection" in the face of uncertain feasibility and other factors.

Indubitable equivalence, thus, requires a broader assessment, circumstances and options in how a creditor should be treated in a case. It is an option in adequate protection, but only one option. The inclusion of this term in the statute was intended to permit flexibility to fit the facts of each case. This flexibility may lead to payment of interest or to other steps to protect a creditor in some cases. In others, adequate protection is met by merely insuring against, compensating for or acting to avoid declining value caused by depreciation or loss of collateral.

IV.

UNDER SECTIONS 361 AND 362, BANKRUPTCY COURTS HAVE THE RIGHT, BUT NOT THE OBLIGATION TO REQUIRE PAYMENTS OR OTHER TRANSFERS IN EXCESS OF DEPRECIATION AS COMPENSATION FOR DELAY AND FOR RISK

The concept of adequate protection that emerges from the language of the Bankruptcy Code and its legislative history is that of a flexible remedy permitting courts to adjust protection to fit the facts of individual cases.

In fitting the statutory standard to individual cases, Bankruptcy and District Courts use a variety of factors to reconstruct aspects of the bargain of the parties and to protect the secured creditor's position consistent with the overall interests of the other parties in the case. Nimmer, *Secured Creditors and the Automatic Stay: Variable Bargain Models of Fairness*, 69 Minn. L. Rev. 1, 14-16 (1983). A mixture of replacement liens, payments, insurance and similar actions are used to tailor the court's reaction to the degree of risk being placed on a secured creditor and the degree to which a bankruptcy estate is able to compensate in a manner consistent with continuing to attempt a reorganization.

As we have shown above, requiring interest in all cases is not consistent with the statute, appropriate policy or

with the flexible character of this remedy. Contrary to the panel decision of the Court below, however, the Code permits courts to require compensation for delay in some cases.

Section 361 defines three alternative means of giving a creditor adequate protection. According to Section 361, adequate protection can be in the form of payments (compensating for depreciation), replacement liens (to the extent of depreciation) *or* such other steps as provide the creditor with the indubitable equivalent of its secured claim. 11 U.S.C. § 361.

The plain meaning is that "indubitable equivalence" may but need not always, be used to define a standard of protection and that, when used, the standard is different from merely protecting against depreciation. This authorizes the trial court to require compensation for delay in some cases, but not others.

The phrase "indubitable equivalent" was first used in *In re Murel* under the former Bankruptcy Act. While one can argue about the full meaning of this term, the simple fact is that in Sections 361 and 362, Congress did *not* require indubitable equivalence in all cases, but did authorize a court to use the *Murel* standard to measure required protection in cases where the facts justify this more stringent standard. Compensation for delay imposed on a case by case basis is authorized by the Code.

This result is consistent with the position of the Eighth Circuit Court of Appeals in *In re Briggs Transportation*, 780 F.2d 1339 (8th Cir. 1986). That court rejected the claim that compensation for delay is mandated in all cases, but held that various factors should be balanced to establish in what cases a requirement of interest should be imposed. "Congress has repeatedly expressed its desire to give bankruptcy courts broad discretion. . . . By incorporating flexibility into the Code, Congress plainly intended adequate protection issues to be resolved on a case-by-case basis. . . ." *Briggs* at 1347.

The Court in *Briggs* described various "risk" and "reliance" factors to be included in the analysis. These were the stability of the collateral values, the length of the stay, whether or not the value is increasing, the likelihood of reorganization with or without interest payments, and various other factors. It notes:

> "Flexibility was legislated into the Bankruptcy Code. . . . This reflects Congressional recognition that numerous factors are taken into account by the parties . . . and a wide spectrum of circumstances may exist. [F]inal reconstruction of the creditor's bargain to determine just what interests . . . should be afforded protection . . . is a balancing act best left to the discretion of the bankruptcy judge. *Briggs* at 1348-1349.

This Court should adopt an interpretation of "adequate protection" that facilitates this legislative intent and does not bind Bankruptcy Judges to absolute rules mandating outcomes that will be inappropriate in many cases.

CONCLUSION

In conclusion, we urge that this Court avoid restrictive interpretations that reduce or eliminate the discretion and flexibility legislated into the bankruptcy concept of "adequate protection". Neither a requirement of postpetition interest, nor its absolute preclusion is warranted under the terms of the Bankruptcy Code or its legislative history.

Respectfully submitted,

RAYMOND T. NIMMER
University of Michigan
School of Law
Ann Arbor, Michigan 48109
(313) 764-1358

EDWARD L. RIPLEY
3700 First City Tower
Houston, Texas 77002
(713) 658-8881

CERTIFICATE OF SERVICE

Pursuant to Supreme Court Rules 36 and 28, I, the undersigned hereby certify that the requisite number of true and correct copies of the foregoing Amicus Curiae Brief have been served by first class United States mail, postage prepaid on this ________ day of August, 1987 as follows:

H. Miles Cohn
Schlanger, Cook, Cohn, Mills
& Grossberg
5847 San Felipe, Suite 1700
Houston, Texas 77057
COUNSEL FOR PETITIONER

Leonard H. Simon
Pendergraft, Elam & Simon
1400 Post Oak Boulevard
Suite 600
Houston, Texas 77056
COUNSEL FOR RESPONDENT

____

APPENDIX A

CONSENT TO FILING OF AMICUS CURIAE BRIEF

NO. 86-1602

IN THE
Supreme Court of the United States
October Term, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent

WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

CONSENT TO FILING OF AMICUS CURIAE BRIEF

Raymond T. Nimmer
University of Michigan
School of Law
Ann Arbor, Michigan 48109
(313) 764-1358

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

NO. 86-1602

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,
Respondent

WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

CONSENT TO FILING OF AMICUS CURIAE BRIEF

Pursuant to Rule 36, the parties in this matter hereby consent to the filing by Raymond T. Nimmer of a brief as amicus curiae.

/s/ H. MILES COHN
H. MILES COHN
Counsel for United Savings Association of Texas
SCHLANGER, COOK, COHN, MILLS & GROSSBERG
5847 San Felipe, Suite 1700
Houston, Texas 77057

[SIGNATURES CONTINUED ON NEXT PAGE]

/s/ LEONARD H. SIMON
LEONARD H. SIMON
Counsel for Timbers of Inwood Forest Associates, Ltd.
PENDERGRAFT, ELAM & SIMON
1400 Post Oak Boulevard
Suite 600
Houston, Texas 77056

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
FILED
SEP 30 1987
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

October Term, 1987

No. 86-1602 (10)

UNITED SAVINGS ASSOCIATION OF TEXAS,

Petitioner,

v.

TIMBERS OF INWOOD FOREST ASSOCIATES, LTD.,

Respondent.

On Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit

---

BRIEF FOR AMICI CURIAE NATIONAL ASSOCIATION OF CREDIT MANAGEMENT, KENNETH N. KLEE, AND RICHARD LEVIN IN SUPPORT OF RESPONDENT

RICHARD LEVIN (COUNSEL OF RECORD)
KENNETH N. KLEE
AUDREY J. WOHLGEMUTH
STUTMAN, TREISTER & GLATT
Professional Corporation
3699 Wilshire Boulevard
Suite 900
Los Angeles, California 90010
Telephone (213) 251-5100

Attorneys for Amici Curiae
National Association of
Credit Management,
Kenneth N. Klee, and
Richard Levin

39pp

TABLE OF CONTENTS

Page

I. INTERESTS OF AMICI CURIAE 1

II. SUMMARY OF ARGUMENT 3

III. PRINCIPLES OF CHAPTER 11 4
  A. Introduction 4
  B. The Policy of Rehabilitation 5
  C. The Elements of Successful Rehabilitation 5
  D. The Deficiencies of Prior Law 6
  E. Congress' Solution: The Balanced Approach of Chapter 11 7

IV. THE STATUTORY LANGUAGE 12
  A. The Distinction Between Claims and Creditors 13
  B. The Meaning of "Interest in Property." 14
    1. Section 361 Applies to Property Interests Other Than Liens 14
    2. "Interest in Property" in the Context of a Secured Claim Means Only the Lien on the Collateral 15
  C. The Meaning of "Indubitable Equivalent." 17
    1. *Murel's* Use of "Indubitable Equivalent" Contemplated Protection Only of Principal, Not of Time-Value 18
    2. "Indubitable Equivalent" is Not a Term of Art 19
    3. Section 1129(b) Refers to Present Value; Section 361 Does Not 20
    4. "Indubitable Equivalent" Means an Equal Substitute 21
  D. The Meaning of "Adequate Protection." 22

V. THE COSTS OF DELAY 24
  A. Congressional Allocation of the Costs of Delay 24
  B. Judicial Approval of the Congressional Allocation 26
  C. Compensation for the Costs of Delay 28
  D. Remedies to Minimize Delay 29

VI. CONCLUSION 30

TABLE OF AUTHORITIES

Page(s)

Cases

Acacia Mutual Life Ins. Co. v. Perimeter Park Inv. Assocs. (In re Perimeter Park Inv. Assocs.), 697 F.2d 945 (11th Cir. 1983) 7

Ahlers v. Norwest Bank Worthington (In re Ahlers), 794 F.2d 388 (8th Cir. 1986), *cert. granted in part*, ___ U.S. ___, 107 S. Ct. 3227 (1987) 9

American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry., 233 U.S. 261 (1914) 25

Atlantic Cleaners & Dyers, Inc. v. United States, 286 U.S. 427 (1932) 21

Bamerical Mortgage & Fin. Co. v. Paradise Boat Leasing Corp. (In re Paradise Boat Leasing Corp.), 5 Bankr. 822 (D.V.I. 1980) 23

Bankers Life Ins. Co. v. Alyucan Interstate Corp. (In re Alyucan Interstate Corp.), 12 Bankr. 803 (Bankr. D. Utah 1981) 12, 15

In re Bermec Corp., 445 F.2d 367 (2d Cir. 1971) 27

Blanchette v. Connecticut Gen. Ins. Corps., 419 U.S. 102 (1974) 27

Butner v. United States, 440 U.S. 48 (1979) 4

CTS Corp. v. Dynamics Corp., ___ U.S. ___, 107 S. Ct. 1637 (1987) 4

Canada So. Ry. v. Gebhard, 109 U.S. 527 (1883) 28

Case v. Los Angeles Lumber Prods., 308 U.S. 106 (1939) ... 9, 21

Continental Ill. Nat'l Bank v. Chicago, R.I., & P. Ry., 294 U.S. 648 (1935) 26, 27

Crocker Nat'l Bank v. American Mariner Indus. (In re American Mariner Indus.), 734 F.2d 426 (9th Cir. 1984) 11, 14, 25, 29

First English Evangelical Lutheran Church v. County of Los Angeles, ___ U.S. ___, 107 S. Ct. 2378 (1987) 27

First Nat'l Bank v. Dahlquist (In re Dahlquist), 34 Bankr. 476 (Bankr. D.S.D. 1983) 28

First Nat'l Bank v. Prima Co. (In re Prima Co.), 88 F.2d 785 (7th Cir. 1937) 22, 28

Cases (continued)

Page(s)

Fruehauf Corp. v. Yale Express Sys., Inc. (In re Yale Express Sys., Inc.), 384 F.2d 990 (2d Cir. 1967) 27

General Elec. Mortgage Corp. v. South Village, Inc. (In re South Village, Inc.), 25 Bankr. 987 (Bankr. D. Utah 1982) 12

In re General Stores Corp., 164 F. Supp. 130 (S.D.N.Y. 1958) 19

In re General Stores Corp., 150 F. Supp. 868 (S.D.N.Y. 1957) 19

In re General Stores Corp., 147 F. Supp. 350 (S.D.N.Y. 1957) 19

In re Island Helicopter Corp., 63 Bankr. 515 (Bankr. E.D.N.Y. 1986) 21

Kelly v. Robinson, ___ U.S. ___, 107 S. Ct. 353 (1986) ... 25

Kremer v. Clarke (In re Frank Fehr Brewing Co.), 268 F.2d 170 (6th Cir. 1959) 19

In re Ludlow Valve Mfg. Co., 181 F. Supp. 356 (N.D.N.Y. 1960) 19

MBank Dallas v. O'Connor (In re O'Connor), 808 F.2d 1393 (10th Cir. 1987) 3, 8, 12, 21, 26

Meehan v. Central R.R., 181 F. Supp. 594 (S.D.N.Y. 1960) 19

Metropolitan Life Insurance Co. v. Murel Holding Corp. (In re Murel Holding Corp.), 75 F.2d 941 (2d Cir. 1935) 18, 19, 21

Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection, 474 U.S. 494 (1986) 4, 25

NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984) 4, 5

Nicholas v. United States, 384 U.S. 678 (1966) 24

Ohio v. Kovacs, 469 U.S. 274 (1985) 4

Pagni v. Pleasant Valley, Inc. (In re Pleasant Valley, Inc.), 6 Bankr. 13 (Bankr. D. Nev. 1980) 23

In re Philadelphia & Reading Coal & Iron Co., 117 F.2d 976 (3d Cir. 1941) 27

In re Pine Gate Assocs., 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976) 7

Cases (continued) **Page(s)**

Pistole v. Mellor (In re Mellor), 734 F.2d 1396 (9th Cir. 1984) 11, 12
In re Preble Corp., 12 F. Supp. 1002 (D. Me. 1935) 19
In re Prime, Inc., 15 Bankr. 216 (Bankr. W.D. Mo. 1981). 23
In re Radio-Keith-Orpheum Corp., 106 F.2d 22 (2d Cir. 1939) 19
In re Rainbow Tower Assocs., 5 Bankr. Ct. Dec. (CRR) 493 (Bankr. D. Kan. 1979) 7
Reconstruction Finance Corp. v. Kaplan (In re Waltham Watch Co.), 185 F.2d 791 (1st Cir. 1950) 27
Reconstruction Finance Corp. v. Prudence Co. (In re Prudence Co.), 90 F.2d 587 (2d Cir. 1937) 21
Reiter v. Sonotone Corp., 442 U.S. 330 (1979) 21
In re Schwab Adams Co., 463 F. Supp. 8 (S.D.N.Y. 1978). 19
In re Serbus, 48 Bankr. 5 (Bankr. D. Minn. 1984) 22
Sexton v. Dreyfus, 219 U.S. 339 (1911) 24, 26
State Mutual Life Assurance Co. v. KRO Assocs. (In re KRO Assocs.), 4 Bankr. Ct. Dec. (CRR) 462 (Bankr. S.D.N.Y. 1978) 7
Swarts v. Hammer, 194 U.S. 441 (1904) 25
In re Thompson, 5 Bankr. 667 (Bankr. D.S.D. 1980) 22
United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.), 808 F.2d 363 (5th Cir. 1987) (en banc) 29, 30
United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.), 793 F.2d 1380 (5th Cir. 1986) 7, 28
United States v. Security Indus. Bank, 459 U.S. 70 (1982) 27, 28
United States v. Whiting Pools, Inc., 462 U.S. 198 (1983).... 4, 5
United Va. Bank v. Slab Fork Coal Co. (In re Slab Fork Coal Co.), 784 F.2d 1188 (4th Cir. 1986) 23, 29
In re Vanasdale, 64 Bankr. 92 (Bankr. N.D. Ohio 1986).... 29
Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946) 4, 24, 25
Wright v. Vinton Branch of Mountain Trust Bank, 300 U.S. 440 (1937) 26-27

Page(s)

Constitution

Supremacy Clause, U.S. Const. art. VI 4

Statutes

11 U.S.C. §§ 101-1330 (1982 & Supp. IV 1986) 2
11 U.S.C. § 101(50) 16
11 U.S.C. § 361 ...... 8, 10, 12, 13, 14, 15, 16, 20, 21, 22, 23, 29
11 U.S.C. § 361(3) 14, 17, 21, 23
11 U.S.C. §§ 361-364 12
11 U.S.C. § 362 14
11 U.S.C. § 362(a) 8
11 U.S.C. § 362(d) 16
11 U.S.C. § 362(d)(2) 8
11 U.S.C. § 362(e) 8
11 U.S.C. § 362-364 .... 14, 16
11 U.S.C. § 363 14
11 U.S.C. § 363(a) 23
11 U.S.C. § 363(b) 22
11 U.S.C. § 363(c) 8
11 U.S.C. § 363(c)(2)-(4) 23
11 U.S.C. § 363(c)(3) 8
11 U.S.C. § 363(e) 8, 15, 16
11 U.S.C. § 363(f) 14, 22
11 U.S.C. § 363(f)(3) 15
11 U.S.C. § 363(g) 14
11 U.S.C. § 363(h) 14-15
11 U.S.C. § 363(i) 15
11 U.S.C. § 363(j) 15
11 U.S.C. § 363(k) 15
11 U.S.C. § 364 14
11 U.S.C. § 364(d) 15
11 U.S.C. § 364(d)(1)(B) 16
11 U.S.C. § 502(b) 25
11 U.S.C. § 502(b)(2) 25
11 U.S.C. § 506(a) 8, 13, 15, 28
11 U.S.C. § 506(b) 25

Statutes (Continued) **Page(s)**

11 U.S.C. § 507(b) 29
11 U.S.C. § 522(f)(2) 27
11 U.S.C. § 541(a)(1) 16
11 U.S.C. § 544(b) 16
11 U.S.C. § 546(b) 16
11 U.S.C. § 547(b) 16
11 U.S.C. § 548(a) 16
11 U.S.C. § 548(b) 16
11 U.S.C. § 552(b) 29
11 U.S.C. § 702(a)(1) 13
11 U.S.C. § 722 13
11 U.S.C. § 725 16
11 U.S.C. § 726(a)(2)-(4) 13
11 U.S.C. § 726(a)(5) 25
11 U.S.C. §§ 1101-1174 3
11 U.S.C. § 1111(b) 15
11 U.S.C. § 1123(b)(1) 8
11 U.S.C. § 1129(a)(7)(B) 16
11 U.S.C. § 1129(b) 10, 20
11 U.S.C. § 1129(b)(2) 13, 20
11 U.S.C. § 1129(b)(2)(A) 8, 20
11 U.S.C. § 1129(b)(2)(A)(i)-(iii) 20
11 U.S.C. § 1129(b)(2)(A)(i)(II) 16, 21
11 U.S.C. § 1129(b)(2)(A)(iii) 21
Bankr. R. 3012 28
Bankruptcy Act § 70a, 11 U.S.C. § 110(a) (1976) (repealed 1978) 16
Bankruptcy Act § 77B, 11 U.S.C. § 207 (1934) (repealed 1938) 18
Bankruptcy Act §§ 101-276, 11 U.S.C. §§ 501-676 (1976) (repealed 1978) 6
Bankruptcy Act §§ 301-399, 11 U.S.C. §§ 701-799 (1976) (repealed 1978) 7
Bankruptcy Act §§ 401-526, 11 U.S.C. §§ 801-926 (1976) (repealed 1978) 7

Page(s)

Legislative Materials

H.R. 8200, 95th Cong., 1st Sess. (1977), *enacted as* Pub. L. No. 95-598, 92 Stat. 2549 (1978) (principally codified as amended at 11 U.S.C. §§ 101-1330 (1982 & Supp. IV 1986)) 2
Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 95th Cong., 2d Sess. (1977) 11
S. Rep. No. 989, 95th Cong., 2d Sess. (1978) 5, 11, 12, 15, 16, 22, 23, 25
H.R. Rep. No. 595, 95th Cong., 1st Sess. (1977) 5, 6, 7, 8, 9, 10-11, 12, 13, 15, 16, 22, 23
Rep. of Comm. on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. (1973) 11
124 Cong. Rec. S17409 (1978) 15-16

Secondary Authorities

Books

R. Broude, *Reorganization Under Chapter 11 of the Bankruptcy Code* (1986 ed. 1987 rev.) 23
T. Jackson, *The Logic and Limits of Bankruptcy Law* (1986) 4

Periodicals

Note, *"Adequate Protection" and the Availability of Postpetition Interest to Undersecured Creditors in Bankruptcy*, 100 Harv. L. Rev. 1106 (1987) 17
Casenote, *Adequate Protection Becomes a Creditor's Tool:* In re American Mariner Industries, Inc., 21 Willamette L. Rev. 149 (1985) 11
Anderson, *Adequate Protection of Opportunity Costs After* In re Briggs, 19 Creighton L. Rev. 765 (1986) 29
Casenote, *Bankruptcy — Adequate Protection*, 18 St. Mary's L.J. 1411 (1987) 4

Secondary Authorities (Continued) **Page(s)**

Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 Bus. Law. 441 (1984) 6, 10

Carlson, *Philosophy in Bankruptcy*, 85 Mich. L. Rev. 1342 (1987) 4

Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 Case W. Res. L. Rev. 301 (1982) 7, 8

Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061 (1985) 6, 10, 11, 14, 23

Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 Yale L.J. 857 (1982) 4

Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133 (1979) 6

Klee, *Legislative History of the New Bankruptcy Law*, 28 De Paul L. Rev. 941 (1979) 5

IN THE

Supreme Court of the United States

October Term, 1987

No. 86-1602

United Savings Association of Texas,
Petitioner,

v.

Timbers of Inwood Forest Associates, Ltd.,
Respondent.

On Writ of Certiorari to the United States Court of Appeals For the Fifth Circuit

BRIEF FOR AMICI CURIAE NATIONAL ASSOCIATION OF CREDIT MANAGEMENT, KENNETH N. KLEE, AND RICHARD LEVIN IN SUPPORT OF RESPONDENT

I. INTERESTS OF AMICI CURIAE

The National Association of Credit Management ("NACM"), founded in 1896, represents over 42,000 American businesses of all kinds — manufacturers, wholesalers, service industries, and financial institutions — through their membership in 75 autonomous state and regional credit management associations. When a business customer of one of these companies finds itself in financial trouble, NACM's members and other businesses like them make up the bulk of the *un*secured creditors of the failing business.

Kenneth N. Klee and Richard Levin served as Congressional Committee Staff to Congressman M. Caldwell Butler and to Congressman Don Edwards, the Ranking Minority Member and Chairman, respectively, of the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee, and the co-authors of the bill that became the Bankruptcy Code.[1] As Committee Staff primarily responsible for that bill, Messrs. Klee and Levin were deeply involved in the development and drafting of the Bankruptcy Code. They both now practice bankruptcy law with the Los Angeles, California law firm of Stutman, Treister & Glatt, where their practice consists primarily of representing business debtors in reorganizations.

All parties typically benefit from a successful reorganization because it increases the recovery on unsecured claims, creates new business for suppliers, preserves jobs for the employees of both the debtors and the suppliers, and preserve the investments of the equity owners of the reorganizing business. Any "lost opportunity cost" payment to a secured creditor with inadequate collateral imposes an additional burden on a reorganizing debtor that decreases the likelihood of a successful reorganization and reduces, both in a reorganization case or in any superseding liquidation case, the recovery on unsecured claims and the likelihood of preservation of any interest in a reorganized debtor for its equity owners. Accordingly, Amici support the decision of the court below and urge affirmance.

---

[1] H.R. 8200, 95th Cong., 1st Sess. (1977), *enacted as* Pub. L. No. 95-598, 92 Stat. 2549 (1978) (principally codified as amended at 11 U.S.C. §§ 101-1330 (1982 & Supp. IV 1986)) (hereinafter referred to as "Bankruptcy Code" or "11 U.S.C. § ___").

II. SUMMARY OF ARGUMENT

> [R]eorganization . . . is the ultimate goal of Chapter 11. Hence, the Debtors' efforts are not only to be encouraged, but also their efforts during the administration of the proceeding are to be measured in light of that quest. Because the ultimate benefit to be achieved by a successful reorganization inures to all the creditors of the estate, a fair opportunity must be given to the Debtors to achieve that end. Thus, while interests of the secured creditor . . . are of concern to the court, the interests of all other creditors also have bearing upon the question of whether use of cash collateral shall be permitted during the early stages of administration.
>
> The first effort of the court must be to insure the value of the collateral will be preserved. Yet, prior to confirmation of a plan of reorganization, the test of that protection is not by the same measurements applied to the treatment of a secured creditor in a proposed plan. In order to encourage the Debtors' efforts in the formative period prior to the proposal of a reorganization, the court must be flexible in applying the adequate protection standard.

MBank Dallas v. O'Connor (In re O'Connor), 808 F.2d 1393, 1397-98 (10th Cir. 1987). This Brief demonstrates why this statement is a compelling summary of Congress' policy in favor of reorganization and its balancing of interests in cases under chapter 11 of the Bankruptcy Code[2] and why these considerations require affirmance of the *en banc* decision below.

---

[2] 11 U.S.C. §§ 1101-1174.

III. PRINCIPLES OF CHAPTER 11

A. Introduction.

This case presents an important issue of federal bankruptcy law, involving the interpretation of several, possibly conflicting, provisions of the Bankruptcy Code. It does not present any conflict between competing bodies of federal law,[3] or any conflict between federal bankruptcy and state law.[4] If it did, of course, federal law would take precedence under the Supremacy Clause, U.S. Const. art. VI, unless Congress had not spoken on the issue presented.[5] In this case, however, Congress has enacted a comprehensive statute for the treatment of claims in bankruptcy and reorganization cases. This Court need look no further than that statute. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 162-63 (1946).[6]

---

[3] *E.g., Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494 (1986) (environmental law); *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984) (labor law); *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983) (tax law).

[4] *See, e.g., Ohio v. Kovacs*, 469 U.S. 274 (1985) (state environmental law).

[5] *E.g., Butner v. United States*, 440 U.S. 48 (1979) (conflict between federal common law in bankruptcy and state real property security law).

[6] This Court should not be distracted by state law or by arguments that the courts should ensure that results in bankruptcy cases will have the same economic effect as under state law. "While the economic theorists are understandably concerned with the creditor's inability to make use of his collateral while the bankruptcy proceedings are pending, this theory cannot overcome the weight of established bankruptcy law." Casenote, *Bankruptcy — Adequate Protection*, 18 St. Mary's L.J. 1411, 1433 (1987); *cf. CTS Corp. v. Dynamics Corp.*, ___ U.S. ___, ___, 107 S. Ct. 1637, 1651 (1987) ("The Constitution does not require the States to subscribe to any particular economic theory."). Even if this Court were to consider Professor Jackson's economic analysis, Brief for Amicus Professor Thomas H. Jackson; Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditor's Bargain*, 91 Yale L.J. 857 (1982), that analysis is most seriously flawed. Carlson, *Philosophy in Bankruptcy*, 85 Mich. L. Rev. 1342, n.136 (1987) (criticizing T. Jackson, *The Logic and Limits of Bankruptcy Law* (1986)).

B. The Policy of Rehabilitation.

After 10 years of intensive study, Congress enacted the Bankruptcy Code as the first comprehensive reform of the bankruptcy laws in 40 years. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess. 2–3 (1977) (hereinafter cited as "*House Report*"); S. Rep. No. 989, 95th Cong., 2d Sess. 1–2 (1978) (hereinafter cited as "*Senate Report*"); Klee, *Legislative History of the New Bankruptcy Law*, 28 De Paul L. Rev. 941, 942 (1979). Improvement of the business reorganization provisions of the bankruptcy law was one of the major goals of the 1978 legislation. *See House Report* at 5. Chapter 11 of the Bankruptcy Code contains these revised provisions.

The federal policy of financial rehabilitation, reorganization, and maximization of asset values is firmly reflected in chapter 11 and its legislative history.

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. . . . It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.

House Report at 220. This Court has also recognized successful reorganization as the primary goal of chapter 11. *NLRB v. Bildisco & Bildisco*, 465 U.S. 513 (1984); *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1983).

C. The Elements of Successful Rehabilitation.

The congressional policy of rehabilitation requires that a debtor have time to reorganize. Time permits the debtor to sell surplus assets at market values rather than at distressed sale prices, to incorporate needed assets into the reorganized business to generate more than forced sale values, and to negotiate with creditors to restructure debts. Ultimately, the debtor will be able to repay creditors more from the proceeds of asset sales and future earnings than they would receive from liquidation and foreclosure sales.

However, the time afforded to a debtor to reorganize must be reasonable. Delay "may hurt the debtor's business and leave parties fighting over division of a shrinking pie. Delays in reorganization also increase the risk that assets may be dissipated before they can be distributed." Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1107 (1985); *see House Report* at 259-60. Litigation among parties in interest over the distribution of assets in a reorganization takes more time than successful negotiation. Moreover, the cost of litigation reduces the size of the pie available for distribution. Fortgang & Mayer, *supra*, at 1106-07. Thus, the rehabilitation policy requires an atmosphere that promotes negotiation rather than litigation. Congress therefore designed chapter 11 both to give the debtor time to restructure its business and finances and to encourage the parties to reach agreement, thereby minimizing the time and consequent cost of the process.[7]

D. The Deficiencies of Prior Law.

Congress revised the three reorganization chapters of the former Bankruptcy Act, Chapters X, XI, and XII, each of which was one-sided in its treatment of debtors and creditors, largely because they did not adequately and fairly provide time for reorganization and did not encourage balanced and speedy negotiations. Chapter X[8] permitted adjustment of secured debt, but excluded the debtor from the process and effectively prohibited negotiated settlements. *See House*

---

[7] *House Report* at 224; Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 Bus. Law. 441 (1984); Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 Case W. Res. L. Rev. 301, 362 (1982); Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1105-07 (1985); Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 Am. Bankr. L.J. 133, 134 (1979).

[8] Bankruptcy Act §§ 101-276, 11 U.S.C. §§ 501-676 (1976) (repealed 1978).

Report at 221-22; Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 Case W. Res. L. Rev. 301, 310-15 (1982). By contrast, prior Chapter XI[9] left the debtor in control, effectively required negotiated settlements, and prohibited "cram down," or adjustment of secured debt without the creditor's consent. Coogan, *supra*, at 315-19. Thus, a creditor holding collateral — even collateral that was integral to the operation of the debtor's business — had a nearly absolute veto power over reorganization, possessing the power to demand return of collateral and to control the ultimate shape of the reorganization plan. Chapter XII,[10] on the other hand, permitted debtors to hold off foreclosure on, realize value from, and attempt to restructure financing of distressed real estate projects.[11] Secured creditor protection was at a minimum. *See, e.g., In re Pine Gate Associates*, 2 Bankr. Ct. Dec. (CRR) 1478 (Bankr. N.D. Ga. 1976).[12]

E. Congress' Solution: The Balanced Approach of Chapter 11.

One of the major legislative achievements of the Bankruptcy Code was the combination of the three former reorganization chapters into one, new chapter 11. *House Report* at 261. Congress borrowed from each of chapter 11's predecessors to give the debtor time to reorganize, to encourage the parties to resolve issues by negotiation, and to create a workable and fair reorganization vehicle. *See* Coogan, *Confirmation of a Plan Under the Bankruptcy Code*, 32 Case W. Res. L. Rev. 301, at 320-27 (1982).[13] Congress also adopted secured creditor protection as an important goal of the legislation, *see House Report* at 182-83, but only as part of an overall legislative scheme that balanced the rights of debtors and creditors generally.[14] Thus, while Congress delayed a secured creditor's enforcement of contractual foreclosure remedies to accommodate the policy of rehabilitation, it balanced that delay by requiring adequate protection of the creditor's substantive rights.

---

[9] Bankruptcy Act §§ 301-399, 11 U.S.C. §§ 701-799 (1976) (repealed 1978).

[10] Bankruptcy Act §§ 401-526, 11 U.S.C. §§ 801-926 (1976) (repealed 1978).

[11] *See, e.g., Acacia Mutual Life Ins. Co. v. Perimeter Park Inv. Assocs. (In re Perimeter Park Inv. Assocs.)*, 697 F.2d 945 (11th Cir. 1983); *In re Rainbow Tower Assocs.*, 5 Bankr. Ct. Dec. (CRR) 493 (Bankr. D. Kan. 1979); *State Mutual Life Assurance Co. v. KRO Assocs. (In re KRO Assocs.)*, 4 Bankr. Ct. Dec. (CRR) 462 (Bankr. S.D.N.Y. 1978).

[12] In the congressional deliberations on the Bankruptcy Code, the secured-creditor bar vigorously objected to *Pine Gate* treatment. Yet, it never addressed the issue of the interim delay necessary to reach the reorganization plan stage of the case and the attendant "lost opportunity cost." *United Sav. Ass'n. v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 793 F.2d 1380, 1395-96 (5th Cir. 1986).

Congress' efforts to achieve a balance were motivated in large part by the problem of resolving one of the more

---

[13] Congress strengthened the automatic stay to prevent secured creditors from seizing collateral or enforcing liens, 11 U.S.C. § 362(a); *House Report* at 174-75, authorized use of collateral during the case, even over the secured creditors' objection, 11 U.S.C. § 363(c); *House Report* at 181-83, and modified substantially the treatment of secured debt to permit a lien holder to claim treatment as a secured creditor only to the extent of the value of the collateral. 11 U.S.C. § 506(a); *House Report* at 180-81. Congress gave debtors the ability to restructure secured debt under a reorganization plan. 11 U.S.C. §§ 1123(b)(1), 1129(b)(2)(A).

[14] Congress prohibited use of cash collateral without consent or court approval, 11 U.S.C. §§ 361, 363(c), and required prompt determinations of contests over relief from the stay, *id.* § 362(e), or use of cash collateral. *Id.* § 363(c)(3). Congress authorized relief from the stay if the creditor's interest in property is not adequately protected, although Congress removed lack of equity alone as a ground for such relief if the property is necessary to an effective reorganization. *Id.* § 362(d)(2). And Congress limited use of collateral during the reorganization to use that is consistent with adequate protection. *Id.* § 363(e).

> In recognition of the powers created in bankruptcy law to adjust debtors' and creditors' interests, Congress realized the need to protect creditors from unfair treatment. Hence, it codified the concept of adequate protection into the several aggressive remedies available to debtors and bankruptcy trustees.

MBank Dallas v. O'Connor (In re O'Connor), 808 F.2d 1393, 1396 (10th Cir. 1987).

difficult issues that Congress confronted in integrating all reorganization law into one consolidated procedure — the proper distribution of values under a reorganization plan. The treatment of the "going concern surplus," that is, the surplus of the value of the debtor as a going concern over its value on liquidation, presented an insoluble problem because of strong, conflicting principles. On the one hand, creditors, particularly secured creditors, generally would receive only liquidation value upon full exercise of their nonbankruptcy law remedies. In addition, most successful reorganizations require the debtor's continued participation in the business. *See, e.g., Ahlers v. Norwest Bank Worthington (In re Ahlers)*, 794 F.2d 388 (8th Cir. 1986), *cert. granted in part*, ___ U.S. ___, 107 S. Ct. 3227 (1987). Therefore, since secured creditors would be no worse off than outside of bankruptcy, debtors should be entitled to the going concern surplus that they create. On the other hand, the absolute priority rule of former Chapter X dictated that creditors be paid in full from the going concern value of the enterprise before junior interests (such as the debtor's equity holders) could share in that value. *Case v. Los Angeles Lumber Prods.*, 308 U.S. 106 (1939).

Congress ultimately concluded:

> The question of whether creditors are entitled to the going-concern or liquidation value of the business is impossible to answer. It is unrealistic to assume the bill could or even should attempt to answer that question. Instead, negotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders. The bill only sets the outer limits on the outcome: it must be somewhere between the going-concern value and the liquidation value.

House Report at 224 (footnote omitted).

By setting the outer limits of the negotiated distribution of value, by balancing the rights of all classes of creditors and the debtor during a case under new chapter 11, and by requiring "fair and equitable" treatment of dissenting classes as a condition to nonconsensual reorganization, 11 U.S.C. § 1129(b), Congress created an atmosphere for successful negotiation of reorganization plans. Broude, *Cramdown and Chapter 11 of the Bankruptcy Code: The Settlement Imperative*, 39 Bus. Law. 441, 441 (1984). Chapter 11 encourages the parties to agree, because failure to reach agreement can lead to an expensive and uncertain "fair and equitable" valuation proceeding or to liquidation and the consequent loss of the going concern surplus. Even if the proceeding is successful, the resulting delay might permit losses to mount to such a level that the business cannot be saved. That risk, plus the attendant costs of the process, drives the negotiations that lead to agreements on distribution of values under a reorganization plan. Broude, *supra*; Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1106-07 (1985).

If Congress could not answer the question of ultimate entitlement to the going concern surplus under a reorganization plan, then it certainly could not solve the problem of interim entitlement to the surplus while the parties attempted to agree on a plan. Nor could Congress determine a standard of valuation or prescribe a complete list of means of protection of interests during that period of negotiation:

> [S]ection [361] . . . does not specify how value is to be determined, nor does it specify when it is to be determined. . . . It is expected that the courts will apply the concept in light of the facts of each case and general equitable principles. It is not intended that the courts will develop a hard and fast rule that will apply in every case. . . .
>
> Neither is it expected that the courts will construe the term value to mean, in every case, forced sale liquidation value or full going concern value. There is wide latitude between those two extremes. In any particular case, especially a reorganization case, the determination of which entity should be entitled to the difference between the going concern value and the liquidation value must be based on equitable considerations based on the facts of the case.

House Report at 339; *Senate Report* at 54.[15]

Once again, by its balancing of the administrative powers and remedies and its decision not to allocate values, Congress encouraged prompt negotiation toward a final reorganization plan that divides the worth of the enterprise among classes of creditors and the debtor. A creditor who is protected not only from the *risks* resulting from delay but also from the *costs* of delay lacks the necessary incentive to participate in negotiations to reach agreement quickly on a plan. Casenote, *Adequate Protection Becomes a Creditor's Tool:* In re American Mariner Industries, Inc., 21 Willamette L. Rev. 149, 164 (1985); *see also* Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1106 (1985). Such a creditor can foster delay that is detrimental to all interests in the reorganization. Congress prevented this situation by requiring the cost of delay to be shared among all those who might gain from a successful reorganization.

---

[15] The statement quoted in the text is clearly in response to frequent criticism from secured creditor representatives during the legislative hearings of the statement in the Report of the Bankruptcy Commission that "[a] benchmark in determining the adequacy of protection is the liquidation value of the collateral at the date of the petition." Rep. of Comm. on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., pt. II, § 7-203, note 3, at 237 (1973). *See, e.g., Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary*, 95th Cong., 2d Sess., pt. 3, at 1607, 1754, 1813, 1887-88 (1977).

The proposals in the Brief for Amicus Professor Thomas Jackson that adequate protection be based on the liquidation value of the collateral as of the petition date, Brief at 21, run roughshod over this clear expression of congressional intent rejecting liquidation value as a benchmark of adequate protection. Even the Court of Appeals for the Ninth Circuit, which used liquidation value in *Crocker National Bank v. American Mariner Industries (In re American Mariner Industries)*, 734 F.2d 426 (9th Cir. 1984), accepted the use of market value or going concern value in *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396 (9th Cir. 1984), for the purpose of determining what value must be protected and whether an equity cushion provided protection.

In sum, chapter 11 presents an integrated, balanced approach to all of the problems arising in a reorganization. As such, chapter 11 as a whole, not any isolated provision as applied to a particular kind of transaction, provides the context for construing the statutory language of adequate protection and demonstrates how Congress required the cost of delay inherent in a reorganization to be shared fairly among the parties in order to carry out the policy of rehabilitation.

IV. THE STATUTORY LANGUAGE

Sections 361 through 364 of the Bankruptcy Code, 11 U.S.C. §§ 361-364, the bulk of the so-called "administrative powers," implement this balanced approach to division of values during the pendency of a reorganization case. These sections restrict the actions of both the debtor and its creditors in order to protect the rights of all and to permit the maximization of values. These sections all require "adequate protection" of various "interests in property." Section 361 defines neither phrase but "sets forth three non-exclusive examples of what may constitute adequate protection . . . ." *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396, 1400 (9th Cir. 1984); *see House Report* at 339; *Senate Report* at 54. "[I]ndubitable equivalent . . . is not the exclusive means" of providing adequate protection. *MBank Dallas v. O'Connor (In re O'Connor)*, 808 F.2d 1393, 1396 n.4 (10th Cir. 1987). Indeed, it is not a means at all. "At best, [indubitable equivalent] is a semantic substitute for adequate protection . . . ." *Bankers Life Ins. Co. v. Alyucan Interstate Corp. (In re Alyucan Interstate Corp.)*, 12 Bankr. 803, 809 (Bankr. D. Utah 1981); *accord General Elec. Mortgage Corp. v. South Village, Inc. (In re South Village, Inc.)*, 25 Bankr. 987 (Bankr. D. Utah 1982).

Petitioner seeks lost opportunity costs under section 361 based on the requirement of "adequate protection" of its "interest in property" and on the concept of "indubitable equivalent." Because section 361 does not define these phrases, this Court must construe them by broader reference to the administrative powers and the Bankruptcy Code as a whole. Congress has used each phrase consistently throughout the Bankruptcy Code in a manner that implements Congress' policy of rehabilitation and denies allowance of lost opportunity costs.

A. The Distinction Between Claims and Creditors.

The Bankruptcy Code differs significantly from prior law in the manner in which it treats and describes the treatment of secured claims. As the *House Report* stated:

> Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims [citing proposed 11 U.S.C. § 506], rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is, those creditors that are undersecured. . . . By addressing the problem in terms of claims, the bill makes clear that an un[der]secured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.

House Report at 180-81 (footnote omitted).

Thus, the parlance of the Bankruptcy Code refers neither to "undersecured creditors" nor to "undersecured claims," only to "secured claims" and to "unsecured claims." *See generally* 11 U.S.C. §§ 506(a), 702(a)(1), 722, 726(a)(2)-(4), 1129(b)(2). Exemplifying this dichotomy, section 506(a) bifurcates a so-called undersecured claim into an "allowed secured claim" and an "allowed unsecured claim." 11 U.S.C. § 506(a). Thus, the Bankruptcy Code addresses only claims and liens securing claims, not creditors or creditors' rights.[16] When analyzed in terms of claims rather than creditors, the provisions of section 361 and the meaning of "interest in property" fall properly into place.

B. The Meaning of "Interest in Property."

Section 361 illustrates means for protection of "interest[s] in property." Petitioner, as well as the dissent below, reads the phrase to apply only to the interests of secured creditors. After reading the phrase that narrowly, Petitioner then strains to find meaningful content in section 361(3) as applied only to secured claims. However, many other kinds of property interests are protected under sections 362, 363, and 364 of the Bankruptcy Code. Thus, section 361 and the phrase "interest in property" have meaning without importing into their language peripheral concepts beyond the simple property interest that comprises a secured creditor's lien.

1. Section 361 Applies to Property Interests Other Than Liens.

Petitioner argues, in effect, that section 361(3) requires provision for lost opportunity costs for the creative reason that, if it did not, the section would have little or no independent meaning. Implicit in this argument is the assumption that section 361 and, in particular, paragraph (3) protect only creditors holding liens and, with respect to those creditors, only against the delay caused by the automatic stay. Yet the Bankruptcy Code and its legislative history provide numerous examples of property interests other than liens that Congress intended sections 362-364 to protect[17] and of

---

[16] One of the major flaws in *American Mariner*, 734 F.2d 426, is that it "took the crucial step of considering the effects of the stay on the secured creditor instead of focusing solely on the condition of the collateral." Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1074 (1985) (footnote omitted).

[17] Subsection (f) of section 363 authorizes sale free and clear of "any interest in such property of an entity other than the estate . . . ." 11 U.S.C. § 363(f). Subsection (g) authorizes sale "free and clear of any vested or contingent right in the nature of dower or curtesy." *Id.* § 363(g). Subsection (h) authorizes sale of "both the estate's interest . . . and the interest of any co-owner in property in which the debtor had . . . an undivided

(footnote continued on next page)

significant other events against which holders of such interests might require protection. *See House Report* at 338; *Senate Report* at 49. Significantly, where Congress intended to apply a provision only to secured claims, it did so expressly. *See, e.g.*, 11 U.S.C. §§ 363(f)(3), (k), 364(d), 506(a), 1111(b).

Thus, section 361 must be read broadly to apply to any interest that an entity other than the debtor might have in property in which the debtor also has an interest. Read broadly, the section has substantial meaning apart from the context of protection of the interest of the holder of a secured claim. Therefore, it is not necessary to import "lost opportunity costs" into section 361 to give it content.

2. "Interest in Property" in the Context of a Secured Claim Means Only the Lien on the Collateral.

Petitioner next argues that the phrase "interest in property" in section 361 refers to the entire bundle of rights and remedies that a secured creditor has under nonbankruptcy law. This argument also improperly addresses creditors, not claims. Moreover, the phrase itself, as well as the use of the same or similar phrases in other sections of the Bankruptcy Code, demonstrates that the phrase should not be read so broadly. In the case of a secured claim, it refers only to the lien encumbering the collateral and to the "allowed secured claim" (that is, the value of the property securing the claim).[18]

(footnote continued from preceding page)

interest as a tenant in common, joint tenant, or tenant by the entirety . . . ." *Id.* § 363(h). Subsections (i) and (j) provide certain additional protections for co-owners and for spouses in community property states. *Id.* § 363(i), (j). And subsection (e), overriding all other provisions of section 363, requires adequate protection (as set forth in section 361) of the interest "of an entity that has an interest in property" before any use, sale, or lease of that property under section 363. *Id.* § 363(e).

[18] 11 U.S.C. § 506(a); *Bankers Life Ins. v. Alyucan Interstate Corp.* (*In re Alyucan Interstate Corp.*), 12 Bankr. 803, 808 & nn. 10, 11 (Bankr. D. Utah 1981). "Adequate protection of an interest of an entity in property is

(footnote continued on next page)

Section 70a of the former Bankruptcy Act vested the trustee in bankruptcy "with the title of the bankrupt" to enumerated kinds of property.[19] The Bankruptcy Code instead adopted the concept of "interests of the debtor in property," 11 U.S.C. § 541(a)(1), which might include the debtor's title to property. *House Report* at 367; *Senate Report* at 82. "Interests in property" in section 541(a)(1) "includes all kinds of property, including tangible or intangible property . . . ." *House Report* at 367, *Senate Report* at 82. As such, Congress has used the phrase throughout the Bankruptcy Code to describe interests in property other than mere ownership or title, including the interests of a lessor, lessee, consignor, bailor, or co-owner. *See* 11 U.S.C. §§ 101(50), 544(b), 546(b), 547(b), 548(a), (b), 725 ("interest, *such as* a lien") (emphasis added), 1129(a)(7)(B), (b)(2)(A)(i)(II).

Sections 362(d), 363(e), and 364(d)(1)(B), the three provisions of the Bankruptcy Code that require adequate protection, all refer to protection of an "interest in property," not to protection of creditors' rights or remedies. The Petitioner argues that the reference is broader than a mere lien or the value of the property that is subject to the lien, because a simple reference to "property" rather than "interest in property" would have sufficed if Congress intended that only the value of the property be protected. But a simple reference to "property" would include the entire bundle of rights associated with the property, including the estate's interest in the property, whereas section 361's reference to a specific third party's interest in property is limited to the rights of that specific entity in the property.

Rather than encompass all conceivable rights and remedies of a secured creditor, the breadth of the phrase "interest in property" spans the breadth of the kinds of interests that sections 362-364 protect. As discussed above, not all of those

---

(footnote continued from preceding page)

intended to protect a creditor's allowed secured claim." 124 Cong. Rec. S17409 (1978).

[19] Bankruptcy Act § 70a, 11 U.S.C. § 110(a) (1976) (repealed 1978).

interests are liens. Note, *"Adequate Protection" and the Availability of Postpetition Interest to Undersecured Creditors in Bankruptcy*, 100 Harv. L. Rev. 1106, 1116 & n.54 (1987).[20] Even within the narrow context of secured claims, not all of the kinds of events against which protection must be afforded are concerned with decline in value of a creditor's interest in property. For example, requiring the estate to insure property, to provide guard service, or to require prompt reporting of financial and other information provides other protections, such as against the *risk* of loss, rather than against only the event of loss.

While Congress used "interest in property" to describe many different property rights, the phrase refers neither to enforcement powers or remedies to realize the benefit of the interest in property, nor to creditors' rights or remedies in general. Congress' use of the general and broad term "interest in property" therefore should not be read to require protection of state law contractual remedies that are not property rights, such as the ability to foreclose on the property subject to a lien at a time of the creditor's choosing.

C. The Meaning of "Indubitable Equivalent."

As it does with the phrase "interest in property," Petitioner reads too much into the other key phrase in section 361(3), "indubitable equivalent," by asserting that the phrase "has long been interpreted to require protection of the time value of the secured creditor's rights." Brief for Petitioner at 16. To the contrary, the language was originally used to protect a secured creditor's rights in its principal, not the time-value of its remedy of foreclosure and reinvestment of proceeds. The phrase had not, when Congress used it in 1978, become a term of art with a well-defined meaning, and its use in another section of the Bankruptcy Code with an explicit time-value reference negates the presence of any time-value content in the phrase itself.

---

[20] For example, a bailor holds ownership while the estate holds merely a possessory interest; a lessee holds a possessory interest while the estate holds the residual interest of a lessor.

1. *Murel's* Use of "Indubitable Equivalent" Contemplated Protection Only of Principal, Not of Time-Value.

Congress plucked the phrase "indubitable equivalent" from Judge Learned Hand's opinion in *Metropolitan Life Insurance Co. v. Murel Holding Corp. (In re Murel Holding Corp.)*, 75 F.2d 941 (2d Cir. 1935), where Judge Hand used it to describe the protection to which a secured creditor would be entitled as part of reorganization plan under Section 77B of the former Bankruptcy Act.[21] Under the plan proposed in *Murel*, "[t]he mortgagee [was] to be compelled to forego all amortization payments for ten years and take its chances as to the fate of its lien at the end of that period, though it [was at the time of confirmation] secured by a margin of only ten percent." 75 F.2d at 942-43. The mortgagee was to receive interest only for that period at five and one-half percent. Judge Hand held that the plan did not provide "adequate protection" of the creditor's rights as required by former Section 77B(b)(5) and denied confirmation of the plan, even though the plan provided for interest at a reasonable market rate, because the creditor's *principal* was placed at risk:

> It is plain that "adequate protection" must be completely compensatory; and that payment ten years hence is not generally the equivalent of payment now. Interest is indeed the common measure of the difference, *but a creditor who fears the safety of his principal will scarcely be content with that; he wishes to get his money or at least the property.* We see no reason to suppose that the statute was intended to deprive him of that in the interest of junior holders, unless by a substitute of the most indubitable equivalence.

Id. at 942 (emphasis added). "Indubitable equivalence" in *Murel* thus stands for the protection of principal and the nominal value of the collateral itself, not for protection of interest, loss of use of principal, opportunity to reinvest principal, or time-value.

2. "Indubitable Equivalent" is Not a Term of Art.

Petitioner describes the phrase "indubitable equivalent" as a term of art, with a well-known definition and a widely accepted meaning when Congress enacted the Bankruptcy Code. Brief for Petitioner at 13. However, in the 43 years between *Murel* and the Bankruptcy Code's enactment, only nine reported opinions used the phrase. Those opinions did nothing to define "indubitable equivalence," to create a term of art, or to suggest that it means protection for the time-value of a secured creditor's rights.

Only one of those opinions construes and applies the phrase. *In re Preble Corp.*, 12 F. Supp. 1002, 1004 (S.D. Me. 1935), held that discharge of a mortgage under a reorganization plan upon payment of an appraised value without allowing the mortgage holder to bid on the collateral to protect the security did not provide the "indubitable equivalence" of the lien. Three of those opinions were issued in a single reorganization case. They neither discussed nor applied the phrase. *In re General Stores Corp.*, 164 F. Supp. 130, 145 (S.D.N.Y. 1958); *In re General Stores Corp.*, 150 F. Supp. 868, 871 (S.D.N.Y. 1957); *In re General Stores Corp.* 147 F. Supp. 350, 353 (S.D.N.Y. 1957).[22]

In re Radio-Keith-Orpheum Corp., 106 F.2d 22 (2d Cir. 1939), never reached the meaning of the phrase, because the affected class had consented to the plan. *Id.* at 250. Finally, three other cases used "indubitable equivalence" in contexts that have nothing to do with adequate protection of a creditor with inadequate collateral. *Kremer v. Clarke (In re Frank Fehr Brewing Co.)*, 268 F.2d 170, 179 (6th Cir. 1959) (unsecured creditors); *In re Schwab Adams Co.*, 463 F. Supp. 8, 12 (S.D.N.Y. 1978) (oversecured creditor); *In re Ludlow*

---

[21] Bankruptcy Act § 77B, 11 U.S.C. § 207 (1934) (repealed 1938).

[22] The District Judge who authored *General Stores* decisions also used the phrase in a nonbankruptcy case involving a wrongful death statute. *Meehan v. Central R.R.*, 181 F. Supp. 594 (S.D.N.Y. 1960).

Valve Mfg. Co., 181 F. Supp. 356, 358 (N.D.N.Y. 1960) (general description of Chapter X).

Thus, the few cases that used the phrase "indubitable equivalence" before the enactment of the Bankruptcy Code each involved different, inapposite circumstances, none of which shed any light on whether the phrase requires interim interest payments during a reorganization case to an inadequately secured creditor.

3. Section 1129(b) Refers to Present Value; Section 361 Does Not.

Congress used the phrase "indubitable equivalent" in one other section of the Bankruptcy Code in dealing with the treatment of secured claims under a nonconsensual chapter 11 plan. Section 1129(b)(2)(A) permits modification of a secured claim under a reorganization plan without the consent of the class in which that claim is placed if the plan is "fair and equitable" with respect to the class.[23]

The form of section 1129(b)(2)(A) is the same as the form of section 361: two specific examples followed by a general description. But the content differs markedly: the specific examples in section 1129(b)(2) refer explicitly to time-value

---

[23] To be "fair and equitable," the plan must meet the following requirements, among others:

> (i)(I) that the holders of such claims retain the liens securing such claims . . . and
>
> (II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, *as of the effective date of the plan*, of at least the value of such holder's interest in the estate's interest in such property;
>
> (ii) for the sale . . . of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or
>
> (iii) for the realization by such holders of the indubitable equivalent of such claims.

11 U.S.C. § 1129(b)(2)(A)(i)-(iii) (emphasis added).

("value, as of the effective date of the plan," 11 U.S.C. § 1129(b)(2)(A)(i)(II)), as does the general "fair and equitable" rule itself. *See Case v. Los Angeles Lumber Prods.*, 308 U.S. 106 (1939). In section 361, by contrast, the general "adequate protection" rule does not by its terms have a time-value content, and the specific examples of adequate protection refer not to time-value but to asset value.

When Congress uses the same phrase in two places in a statute, there is a presumption that the phrase should be given the same meaning in both places. *Atlantic Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932). Congress used "indubitable equivalent" in section 1129(b)(2)(A)(iii) without internal time-value content, infusing that content by the context and the rule of which the phrase is a part. Similarly, Congress used "indubitable equivalent" in section 361(3) without time-value content; as in *Murel*, 75 F.2d 941, Congress infused the phrase with the concept of protection of asset value by the context and the rule of which the phrase is a part.

4. "Indubitable Equivalent" Means an Equal Substitute.

Despite the vagueness of the phrase "indubitable equivalent," Congress should not be presumed to have used it without some meaning. *Reiter v. Sonotone Corp.*, 442 U.S. 330, 339 (1979). As the phrase is not a term of art and does not have unique time-value content, this Court should give the phrase its ordinary meaning, namely, a substitute of something that will undoubtedly prove equal to the property interest being affected. *See Reconstruction Finance Corp. v. Prudence Co. (In re Prudence Co.)*, 90 F.2d 587, 589 (2d Cir. 1937) (requiring an "acceptable substitute").[24]

---

[24] For example, in the context of secured debt, a substitute lien on property of comparable quality and value should be the indubitable equivalent of the lien holder's original lien. *See, e.g., MBank Dallas v. O'Connor (In re O'Connor)*, 808 F.2d 1393 (10th Cir. 1987) (debtor could use cash collateral to drill gas well in proven field; lien to attach to well); *In re Island Helicopter Corp.*, 63 Bankr. 515, 523 (Bankr. E.D.N.Y. 1986) (debtor could use insurance proceeds of destroyed collateral where

(footnote continued on next page)

The holder of an interest in property of the estate, whether a lien or something else, is entitled under the "indubitable equivalent" standard to something that the bankruptcy judge determines constitutes an equal substitute, despite a particular interest holder's preference for one kind of collateral or one kind of protection. That is what Congress must have meant by the words "indubitable equivalent" and by the Committee Reports' language that the interest holder "might not receive his bargain in kind [but should] receive[ ] in value essentially what he bargained for." *House Report* at 339; *see Senate Report* at 53.[25] That is all this Court should construe "indubitable equivalent" to mean, for the language clearly does not include a requirement of compensation for the time-value of a lien holder's interest.

D. The Meaning of "Adequate Protection."

The foregoing demonstrates that in the context of a secured claim, section 361's "interest in property" means the creditor's lien, and "indubitable equivalent" means an equal substitute. Thus, the requirement that the holder of a secured claim receive adequate protection means only that the holder must receive an equal substitute for the lien, even though the holder might not receive or have the direct benefit of the lien itself. For example, if an asset of the estate is sold free and clear of a lien under subsections (b) and (f) of section 363, adequate protection of the lien holder's property interest might require a substitute lien on a different asset of the same or greater value, or even on the sale proceeds.

(footnote continued from preceding page)

replacement lien was given on new components). *In re Serbus*, 48 Bankr. 5 (Bankr. D. Minn. 1984) (substitute lien on replacement cows purchased with cash collateral proceeds of original cows); *In re Thompson*, 5 Bankr. 667 (Bankr. D.S.D. 1980) (substitute lien on bees, beehives, and honey crop acquired with cash collateral proceeds of prior year's honey crop).

[25] Even that language ("benefit of the bargain") does not mandate protection of all of the creditor's *state* law rights and remedies, for part of every "bargain" is the bankruptcy law. *First Nat'l Bank v. Prima Co. (In re Prima Co.)*, 88 F.2d 785, 788 (7th Cir. 1937).

House Report at 345; *Senate Report* at 56. Adequate protection of the interest of the holder of a lien encumbering a revenue-producing asset might consist of segregation and perhaps turnover to the lien holder of the net revenues from the asset.[26]

Other forms of adequate protection of a lien in property that the estate retains to aid in the reorganization might include proper management of the property (such as the apartment building in this case), proper insurance protection against usual risks, and proper security in the form of guard service or other physical protection.[27] Even the provision of a third party guarantee or the right of the lien holder to bid at a sale of the property (if the property is to be sold) may constitute adequate protection.[28]

These various forms of adequate protection suggest a better and more complete reading of the generality of "adequate protection" and section 361(3) than the Petitioner's narrow focus on protection merely of the lien holder's desire to foreclose at a time and in a manner of its choosing and to reinvest the proceeds elsewhere. Section 361 does not protect the investment preferences of creditors. If the estate provides reasonable and adequate management of encumbered assets and compensates for actual depreciation or consumption of the collateral, then the value of the assets and of the lien is protected, and the return should be commensurate with an alternate investment of the same assets (or their value) elsewhere or in other hands. In contrast, permitting a secured creditor to demand the benefit of an alternate investment is incompatible with the rehabilitation of distressed debtors and with the realization for the estate, including unsecured creditors, of more than forced sale value of the lien holder's collateral.

---

[26] *See* 11 U.S.C. § 363(c) (2)-(4) (segregation of "cash collateral," which might include proceeds, rents, or profits of collateral. *Id.* § 363(a)). If the lien holder were to take possession of the asset, he would also obtain possession of the net revenues of the asset, so segregation or turnover of net revenues might provide, in the appropriate case, the same benefit as the lien itself. *United Va. Bank v. Slab Fork Coal Co. (In re Slab Fork Coal Co.)*, 784 F.2d 1188, (4th Cir. 1986) (postpetition cash proceeds of prepetition supply contract paid to secured creditor). *See* Fortgang & Mayer, *Valuation in Bankruptcy*, 32 UCLA L. Rev. 1061, 1082-83 (1985).

[27] *See, e.g., Bamerical Mortgage & Fin. Co. v. Paradise Boat Leasing Corp. (In re Paradise Boat Leasing Corp.)*, 5 Bankr. 822 (D.V.I. 1980) (insurance); *In re Prime, Inc.*, 15 Bankr. 216 (Bankr. W.D. Mo. 1981) (monitoring of accounts, audits); *Pagni v. Pleasant Valley, Inc. (In re Pleasant Valley, Inc.)*, 6 Bankr. 13 (Bankr. D. Nev. 1980) (effect of inflation, payment of taxes, assessments, and insurance).

[28] *See, e.g., House Report* at 340 (guarantees, right to bid); R. Broude, *Reorganization Under Chapter 11 of the Bankruptcy Code*, § 4.06[2], at 4-47 (1986 ed. 1987 rev.) (collecting cases finding certain third-party guarantees as adequate protection).

V. THE COSTS OF DELAY

Congress has compelled the lien holder to accept adequate protection of his interest as a substitute during the time it takes to complete the reorganization process. The delay that reorganization occasions will not necessarily be cost-free. But Congress has dictated that the cost of delay be borne by all creditors who have not obtained adequate collateral to protect against all costs and risks, because they stand to benefit by the realization of the debtor's going concern value upon a reorganization. This Court has approved that policy decision under prior bankruptcy laws and should approve it once again, with appropriate protections to keep delay within reasonable bounds.

A. Congressional Allocation of the Costs of Delay.

Interest is the measure of delay in payment of debts. For over 200 years, bankruptcy law has stopped interest from running when a petition is filed. *Sexton v. Dreyfus*, 219 U.S. 339, 344 (1911). The rule originally was based on equitable principles, not on any statute. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 163 (1946). The courts readily accepted the rule in reorganization cases under Chapter XI of the former Bankruptcy Act. *Nicholas v. United States*, 384 U.S. 678, 686 (1966).[29] Thus, by the time the

---

[29] Under the common law, exceptions evolved to the general rule. A secured creditor was entitled to postpetition interest, but only to the extent that the principal of the debt plus accrued interest did not exceed

(footnote continued on next page)

Bankruptcy Code was enacted, it was well established that a creditor with collateral worth less than his claim was not entitled to postpetition interest on the secured claim.

If Congress intends for legislation to change the interpretation of a well-established, judicially-created concept, it must make this intent specific. *Kelly v. Robinson*, ____ U.S. ____, ____, 107 S. Ct. 353, 359-60 (1986); *Midlantic Nat'l Bank v. New Jersey Dept. of Envtl. Protection*, 474 U.S. 494, ____, 106 S. Ct. 755, 760 (1986). Thus, if Congress intended to allow interest on an undersecured claim or to compensate its holder otherwise for the inherent delay in bankruptcy cases, "the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt," *Swarts v. Hammer*, 194 U.S. 441, 444 (1904), or, for that matter, from disputable economic considerations of the kind that the *American Mariner* decision relies on. 734 F.2d 426 (9th Cir. 1984).

To the contrary, Congress specifically codified the provisions of the traditional rule without change.[30] Congress could not have codified "current law" on the postpetition interest issue so carefully while intending the revolutionary treatment of the undersecured claim in *American Mariner*, 734 F.2d 426, without any mention of such a change.

(footnote continued from preceding page)

the value of the collateral securing the debt. *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156, 164 (1946). Interest also might be paid on unsecured claims if the debtor's estate ultimately proved solvent. *Id.* at 164-65; *American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261, 266-67 (1914).

[30] Section 502(b)(2) generally disallows postpetition interest, 11 U.S.C. § 502(b)(2), while section 506(b) allows postpetition interest on a secured claim if the collateral is worth enough to cover it. *Id.* § 506(b). Section 726(a)(5) grants creditors postpetition interest in the case of a solvent chapter 7 estate. *Id.* § 726(a)(5). The legislative history confirms that Congress intended to codify current law on these issues. *Senate Report* at 63, 68 (section 502(b) "contains two principles of present law"; section 506(b) "codifies current law").

By denying interest on unsecured and undersecured claims, the Bankruptcy Code demonstrates Congress' intent that the cost of delay be shared by all creditors who did not bargain for and receive collateral of adequate value to compensate for all risks of the loan, including the risk of a bankruptcy and its attendant delays. That policy decision was entirely reasonable, particularly with respect to the holder of an inadequately secured claim. Such a holder stands to gain from a successful reorganization,[31] and to a greater extent than the holders of unsecured claims because the increased going concern value of collateral resulting from a successful reorganization inures fully to his benefit and need not be shared with other creditors. *See Sexton v. Dreyfus*, 219 U.S. 339, 345 (1911). Congress' decision in 1978 continues a well-established policy of bankruptcy rehabilitation that this Court has recognized, fostered, and approved.

B. Judicial Approval of the Congressional Allocation.

This Court has recognized that delay is an inherent part of the bankruptcy process and has held that the Constitution permits reasonable delays in the reorganization process. In *Continental Illinois National Bank and Trust Company v. Chicago, Rock Island & Pacific Railway*, 294 U.S. 648 (1935), this Court upheld a stay of lien enforcement against constitutional attack in part because it "contemplate[d] . . . only reasonable delay." 294 U.S. at 685.[32] In *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440 (1937), this Court also upheld a stay without compensation

---

[31] *See MBank Dallas v. O'Connor (In re O'Connor)*, 808 F.2d 1393, 1397-98 (10th Cir. 1987).

[32] The injunction here in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action. It may be, as suggested, that during the period of restraint the collateral will decline in value; but the same may be said in respect of an injunction against the sale of real estate upon foreclosure of a mortgage; and such an injunction may issue in an ordinary proceeding in bankruptcy.

294 U.S. at 676-77.

(but with certain protections of collateral value) against constitutional attack, stating:

> To carry out the purposes of the Bankruptcy Act, [a court of bankruptcy] . . . may enjoin sale of the collateral, if it finds that the sale would hinder or delay preparation or consummation of a plan of reorganization. [citing *Continental Illinois, supra.*] It may enjoin like action by a mortgagee which would defeat the purpose of subsection (a) to effect rehabilitation of the farmer mortgagor.

Id. at 470. *See Blanchette v. Connecticut General Insurance Corps.*, 419 U.S. 102, 123-24 (1974) (suggesting that losses incurred as a result of a reasonable delay pending confirmation of a reorganization plan do not constitute an unconstitutional taking).

The lower courts have reached the same conclusions. *E.g. In re Bermec Corp.*, 445 F.2d 367 (2d Cir. 1971); *Fruehauf Corp. v. Yale Express Sys., Inc. (In re Yale Express Sys., Inc.)*, 384 F.2d 990 (2d Cir. 1967); *Reconstruction Finance Corp. v. Kaplan (In re Waltham Watch Co.)*, 185 F.2d 791, 796 (1st Cir. 1950); *In re Philadelphia & Reading Coal & Iron Co.*, 117 F.2d 976, 979 (3d Cir. 1941).[33]

---

[33] *First English Evangelical Lutheran Church v. County of Los Angeles*, ___ U.S. ___, ___, 107 S. Ct. 2378, 2388 (1987), does not require a contrary result. In that case, this Court said,

> "temporary" takings which . . . deny a *landowner all* use of *his* property, are not different in kind from permanent takings, for which the Constitution clearly requires compensation.

(Emphasis added). While a lien constitutes protectable property, *United States v. Security Indus. Bank*, 459 U.S. 70, 76 (1982), Petitioner acknowledges that its lien does not constitute *ownership* of the collateral. *See* Brief for Petitioner at 36. Moreover, the imposition of the automatic stay for a reasonable period does not deny the secured creditor "all use of his property [the lien]", for the lien remains to secure payment of the claim. That is, although the remedy is delayed, the rights in the collateral are not affected. *See Continental Ill. Nat'l Bank v. Chicago, R.I., & P. Ry.*, 294 U.S. 648, 676 (1935). *Compare with United States v. Security Indus. Bank*, 459 U.S. at 81-82 (applying section 522(f)(2) of the Bankruptcy Code prospectively only, because it deprived the lien holder of its lien).

Thus, the courts have recognized and approved delay and the imposition on lien holders of the costs of delay as one of the by-products of a reorganization that must be borne in the interest of rehabilitation and maximization of values for the benefit of all, including those secured creditors who would profit by the realization of more than forced sale liquidation value. As this Court stated over 100 years ago:

> Every member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relation to others, he might have retained. Such concessions make up the consideration he gives for the obligation of the body politic to protect him in life, liberty, and property. Bankrupt laws, whatever may be the form they assume, are of that character.

Canada So. Ry. v. Gebhard, 109 U.S. 527, 536 (1883). It is too late in the development of reorganization law to argue that the holder of an inadequately secured claim cannot be required to bear that cost, particularly since Congress clearly reaffirmed its long-standing policy on this issue when it enacted the Bankruptcy Code.[34]

C. Compensation for the Costs of Delay.

Nevertheless, Congress provided some compensation for costs of delay to the holder of an inadequately collateralized claim. The creditor's interest in property ("allowed secured claim") is not fixed permanently at an early adequate protection hearing, but must be revalued at the plan confirmation hearing. 11 U.S.C. § 506(a); Bankr. R. 3012. It may increase as the value of the collateral increases. *See, e.g., First Nat'l Bank v. Dahlquist (In re Dahlquist),* 34 Bankr. 476 (Bankr.

---

[34] Even if Congress had changed the law on this subject in 1978, that would not present a constitutional impediment to its application in this case, as the lien here was granted in 1982, well after the effective date of the statute. *Timbers,* 793 F.2d 1380, 1383. Any contract or property right is subject to the bankruptcy laws in force at the time the contract is made or the property right is acquired. *First Nat'l Bank v. Prima Co. (In re Prima Co.),* 88 F.2d 785, 788 (7th Cir. 1937); *see United States v. Security Indus. Bank,* 459 U.S. at 79-81.

D.S.D. 1983) (secured claim protected where collateral appreciating). Thus, Congress both protected the creditor's claim against *deterioration* of the value of the collateral (to the extent the secured claim is allowed at a hearing on adequate protection), *id.* §§ 361, 507(b), *and* entitled the holder of the claim to share in any appreciation and in the going-concern surplus in the property that is available upon plan confirmation. Anderson, *Adequate Protection of Opportunity Costs After* In re Briggs, 19 Creighton L. Rev. 765, 785 (1986).[35]

D. Remedies to Minimize Delay.

Delay in bankruptcy is not unlimited. As this Court has recognized, delay must be reasonable and must be only for the purpose imposed by the Bankruptcy Code. The Bankruptcy Code grants all creditors ample remedies to minimize the delay inherent in the chapter 11 process and keep it within reasonable bounds. *United Sav. Ass'n. v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assoc.),* 808 F.2d 363, 370-72 (5th Cir. 1987) (en banc). These creditor remedies are designed to put pressure on the debtor to negotiate an acceptable reorganization plan.

Moreover, as the court below indicated, the bankruptcy courts have an obligation to enforce these creditor remedies, to protect debtors only when meaningful reorganization is at stake, and to countenance delay only for that purpose. *Timbers*, 808 F.2d at 373-74. That too will maintain the balance that Congress intended to prevail in the process as a means of encouraging negotiated settlements and avoiding protracted, expensive litigation over precise legal rights and entitlements. The delicate balance of the Bankruptcy Code would be disrupted irreparably if undersecured creditors were compensated for the cost of delay, because such compensation would reduce their incentive to negotiate.

---

[35] Section 552(b) generally grants the holder of a security interest the appreciation in the property even if a plan is not confirmed. 11 U.S.C. § 552(b). That section extends a prepetition security interest to proceeds, product, offspring, rents, and profits of existing collateral acquired postpetition, except to the extent the equities of the case require otherwise. This may allow the lien holder the "profit" on processed collateral, after reimbursement to the estate of the processing costs. *E.g., In re Vanasdale,* 64 Bankr. 92 (Bankr. N.D. Ohio 1986) (secured lender receives crop proceeds less cost to grow crops); *see United Va. Bank v. Slab Fork Coal Co. (In re Slab Fork Coal Co.),* 784 F.2d 1188, 1191 (4th Cir. 1986) (postpetition cash proceeds of prepetition coal supply contract paid to secured lender, although equities of the case might sometimes dictate otherwise). Thus, the creditor normally receives the additional protection of potential increased value as compensation for the delay. But the *American Mariner* rule, 734 F.2d 426, *requires* income payments to the lien holder and thereby removes the equitable discretion that Congress granted to the bankruptcy courts in section 552(b).

VI. CONCLUSION

Congress designed an integrated, balanced statutory scheme to enable debtors in financial distress to reorganize. That scheme requires time and constructive negotiations among all parties in interest. The Bankruptcy Code balances the rights, remedies, and risks of all parties in order to effect Congress' design. The court below properly interpreted this balance by denying Petitioner's plea for effective immunity from the costs and risks of reorganization. This Court must affirm, lest it enter the legislative realm and disrupt the delicate balance that Congress so carefully crafted.

Respectfully submitted,

RICHARD LEVIN *(Counsel of Record)*
KENNETH N. KLEE
AUDREY J. WOHLGEMUTH
STUTMAN, TREISTER & GLATT
Professional Corporation

Attorneys for Amici Curiae
National Association of
Credit Management,
Kenneth N. Klee, and
Richard Levin

September 1987

AMICUS CURIAE

BRIEF

(12)

Supreme Court, U.S.
FILED
OCT 1 1987
JOSEPH F. SPANIOL, JR.
CLERK

No. 86-1602

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF GLOBAL MARINE INC., CHAPTER 11 DEBTOR IN POSSESSION, AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

HARVEY R. MILLER*
D. J. BAKER
MARTIN J. BIENENSTOCK
ROSALIE E. WALKER
WEIL, GOTSHAL & MANGES
767 Fifth Avenue
New York, New York 10153
(212) 310-8000
-and-
1600 RepublicBank Center
Houston, Texas 77002
(713) 546-5000

Attorneys for *Amicus Curiae,*
Global Marine Inc.,
Chapter 11 Debtor in
Possession

JOHN G. RYAN
General Counsel
Global Marine Inc.
777 North Eldridge
Houston, Texas 77079
(713) 596-5100

* Attorney of Record

QUESTION PRESENTED

If a chapter 11 case takes longer than would foreclosure and sale under state law, do sections 361 and 362(d) of the Bankruptcy Code require that an undersecured claimholder be compensated for that delay from unencumbered assets of the debtor, or would such compensation protect the very remedies replaced by the Bankruptcy Code and create a right for the claimholder that is prohibited by sections 502(b)(2) and 506(b) of the Bankruptcy Code?

TABLE OF CONTENTS

PAGE(S)

QUESTION PRESENTED i

TABLE OF CONTENTS ii

TABLE OF AUTHORITIES iv

DESCRIPTION AND INTEREST OF *AMICUS CURIAE* 1

STATEMENT OF THE CASE 2

SUMMARY OF THE ARGUMENT 3

ARGUMENT 5

I. UNITED SAVINGS IS NOT ENTITLED TO ADEQUATE PROTECTION OF AN INTEREST IN PROPERTY IT DOES NOT HAVE 5

- A. Bankruptcy Code Sections 502(b)(2) and 506(a) Disallow Postpetition Interest on Undersecured Claims 5
- B. Postpetition Interest Does Not Become Allowable by Recharacterizing it as Something "More Like Rent." 8
- C. The Dissent Below Demonstrates that in the Face of Bankruptcy Code Sections 502(b)(2) and 506(b), Only Judicial Legislation Can Sanction Postpetition Interest 9

II. NEITHER THE BANKRUPTCY CODE NOR ITS LEGISLATIVE HISTORY EVINCE ANY INTENT TO CHANGE PRIOR LAW PROVIDING THAT DELAY CAUSED BY AN ACT OF CONGRESS IS NOT CHARGEABLE AGAINST THE DEBTOR OR OTHER CREDITORS 12

III. BANKRUPTCY CODE SECTION 361 RESTRICTS ADEQUATE PROTECTION TO COMPENSATION FOR DEPRECIATION OF COLLATERAL SECURITY 17

- A. The Bankruptcy Code Utilizes "Time Value" Language, But Not in Connection with Adequate Protection 17
- B. The Legislative History Restricts Adequate Protection to Compensation for Depreciation of Collateral Security 20

PAGE(S)

IV. REFUTATION OF MYTHS SUPPORTING LOST OPPORTUNITY COSTS 23

- A. *Butner* Is Not Authority for the Lost Opportunity Costs Theory 23
- B. The Enactment of Chapter 12 Did Not Codify Lost Opportunity Costs in Chapter 11 24
- C. Splitting One Lien into Two Does Not Change Adequate Protection Requirements 26
- D. Chapter 11 Serves National Interests, All Creditors, Employees, and Owners, Not Just Unsecured Creditors 27
- E. *First Lutheran Church* Does Not Apply to the Case at Bar 28

CONCLUSION 30

TABLE OF AUTHORITIES

Cases	PAGE(S)
American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry., 233 U.S. 261 (1914)	13
Bateman Fin. Corp. v. Glanville Mortgage Co. (In re Bateman Fin. Corp.), 5 Collier Bankr. Cas. (MB) 488 (Bankr. M.D. Fla. 1975)	15
In re Bermec Corp., 445 F.2d 367 (2d Cir. 1971)	21, 22
Bistrian v. East Hampton Sand & Gravel Co. (In re East Hampton Sand & Gravel Co.), 25 Bankr. 193 (Bankr. E.D.N.Y. 1982)	25
Butner v. United States, 440 U.S. 48 (1979)	23
C. I. Mortgage Group v. Groundhog Mountain Corp. (In re Groundhog Mountain Corp.), 1 Bankr. Ct. Dec. (CRR) 923 (Bankr. S.D.N.Y. 1975)	15, 16
Coder v. Arts, 213 U.S. 223 (1909)	13
Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R.I. & P.R. Co., 294 U.S. 648 (1935)	14, 19
Crocker Nat'l Bank v. American Mariner Indus., Inc. (In re American Mariner Indus., Inc.), 734 F.2d 426 (9th Cir. 1984)	20, 24-26
Crooks v. Harrelson, 282 U.S. 55 (1930)	12
Emil v. Hanley (In re John M. Russell, Inc.), 318 U.S. 515 (1943)	*15*
First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, ___ U.S. ___, 107 S.Ct. 2378 (1987)	28, 29
First Nat'l Bank of Chicago v. Prima Co. (In re Prima Co.), 88 F.2d 785 (7th Cir. 1937)	29
Fruehauf Corp. v. Yale Express System, Inc. (In re Yale Express System, Inc.), 384 F.2d 990 (2d Cir. 1967)	22
Group of Institutional Investors v. Chicago, M., St.P. & P.R. Co., 318 U.S. 523 (1943)	13
Grundy Nat'l Bank v. Tandem Mining Corp., 754 F.2d 1436 (4th Cir. 1985)	24
Harris Int'l Telecommunications, Inc. v. Three Star Telecast, Inc. (In re Three Star Telecast, Inc.), 73 Bankr. 270 (Bankr. D.P.R. 1987)	25

Cases	PAGE(S)
In re Hartsdale Associates, 11 Collier Bankr. Cas. (MB) 87 (Bankr. S.D.N.Y. 1976)	16
In re Island Helicopter Corp., 63 Bankr. 809 (Bankr. E.D.N.Y. 1986)	24
John Hancock Mut. Life Ins. Co. v. Pullins (In re Pullins), 65 Bankr. 560 (Bankr. S.D. Ohio 1986)	24
In re Keller, 45 Bankr. 469 (Bankr. N.D. Iowa 1984)	24
Koerner v. Colonial Bank (In re Koerner), 800 F.2d 1358 (5th Cir. 1986)	27
Lend Lease v. Briggs Transp. Co. (In re Briggs Transp. Co.), 780 F.2d 1339 (8th Cir. 1985)	16, 24
In re Manville Forest Products Corp., 43 Bankr. 293 (Bankr. S.D.N.Y. 1984)	24, 25
Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494 (1986)	15
In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935)	18, 19, 20
National Life Ins. Co. v. Jenifer Mall Corp. (In re Jenifer Mall Corp.), 2 Collier Bankr. Cas. (MB) 657 (Bankr. D.D.C. 1974)	15
NLRB v. Bildisco and Bildisco, 465 U.S. 513 (1984)	8
In re Park West Hotel Corp., 64 Bankr. 1013 (Bankr. D. Mass. 1986)	24
In re Pine Lake Village Apartment Co., 19 Bankr. 819 (Bankr. S.D.N.Y. 1982)	16
Sexton v. Dreyfus, 219 U.S. 339 (1911)	6
Southside Leasing Co. v. Merchants Plaza, Inc. (In re Merchants Plaza, Inc.), 35 Bankr. 888 (Bankr. E.D. Tenn. 1983)	25
In re Sweetwater, 40 Bankr. 733 (Bankr. D. Utah 1984), *aff'd*, 57 Bankr. 743 (D. Utah 1985)	25
Ticonic Nat'l Bank v. Sprague, 303 U.S. 406 (1938)	13
In re 12th & N Joint Venture, 63 Bankr. 36 (Bankr. D.D.C. 1986)	24
United Savings Ass'n of Texas v. Timbers Of Inwood Forest Associates, Ltd. (In re Timbers of Inwood Forest Associates, Ltd.), 808 F.2d 363 (5th Cir.), *cert. granted*, ___ U.S. ___, 107 S.Ct. 2459 (1987)	passim
United States v. Security Indus. Bank, 459 U.S. 70 (1982)	19, 29

Cases

	PAGE(S)
United States v. Smithfield Estates, Inc. (In re Smithfield Estates, Inc.), 48 Bankr. 910 (Bankr. D.R.I. 1985)	24
United States v. Whiting Pools, Inc., 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983)	15
Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156 (1946)	14, 15
Wright v. Union Central Life Ins. Co., 311 U.S. 273 (1940)	22

Statutes and Legislative History

11 U.S.C. § 109(d)	10
11 U.S.C. § 361	3, 16, 17, 18, 20, 24
11 U.S.C. § 361(1)	17, 18, 21
11 U.S.C. § 361(2)	17, 18
11 U.S.C. § 361(3)	18
11 U.S.C. § 362(a)	23
11 U.S.C. § 365(d)(3)	8
11 U.S.C. § 502	9
11 U.S.C. § 502(b)	5, 9, 23
11 U.S.C. § 502(b)(2)	passim
11 U.S.C. § 506	4
11 U.S.C. § 506(a)	5, 7, 8, 20
11 U.S.C. § 506(b)	5, 6, 7, 9, 13, 27
11 U.S.C. § 506(c)	6, 26
11 U.S.C. § 510	26
11 U.S.C. § 552(b)	7, 27
11 U.S.C. § 726(a)(5)	6, 13
11 U.S.C. § 1107(a)	1, 6
11 U.S.C. § 1108	1
11 U.S.C. § 1110	4
11 U.S.C. § 1110(a)	8
11 U.S.C. § 1112(b)	4, 11, 12, 27

	PAGE(S)
11 U.S.C. § 1121	4, 12
11 U.S.C. § 1121(c)	11
11 U.S.C. § 1129	4
11 U.S.C. § 1129(a)(7)(A)(ii)	6, 18
11 U.S.C. § 1129(a)(9)(B)	18
11 U.S.C. § 1129(b)(2)(A)(i)(II)	18
11 U.S.C. § 1168	4, 8
11 U.S.C. § 1205	24
11 U.S.C. § 1205(b)	24, 25
11 U.S.C. § 1205(b)(1)	24, 26
11 U.S.C. § 1205(b)(2)	24, 26
11 U.S.C. § 1205(b)(3)	25, 26
11 U.S.C. § 1205(b)(4)	25
11 U.S.C. § 1225	4
11 U.S.C. § 1225(a)(4)	18
11 U.S.C. § 1225(b)(1)(A)	18
11 U.S.C. § 1325	4
11 U.S.C. § 1325(a)(4)	18
11 U.S.C. § 1325(a)(5)(B)(ii)	18
11 U.S.C. § 1325(b)(1)(A)	18
Former 11 U.S.C. §§ 1-1103 (repealed 1978)	10
Former 11 U.S.C. § 207	19, 20
H.Rep. No. 595, 95th Cong., 1st Sess. (1977)	10,21,22, 23, 28
S.Rep. No. 989, 95th Cong., 2d Sess. (1978)	21, 22
S. 2266, 95th Cong., 2d Sess. § 362(d) (1977)	11
124 Cong. Rec. H 11089 (Sept. 28. 1978)	21
124 Cong. Rec. H 11092 (Sept. 28, 1978) (statement of Rep. Edwards)	21
124 Cong. Rec. S 17406 (Oct. 6, 1978)	21
124 Cong. Rec. S 17409 (Oct. 6, 1978) (statement of Sen. DeConcini)	21

Other Authorities

M. Bienenstock, *Bankruptcy Reorganization* (1987) ...	29
Black's Law Dictionary (5th ed. 1979)	8
Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 Harv. L. Rev. 973 (1983)	9

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

No. 86-1602

UNITED SAVINGS ASSOCIATION OF TEXAS,
Petitioner,

v.

TIMBERS OF INWOOD FOREST
ASSOCIATES, LTD.,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF OF GLOBAL MARINE INC., CHAPTER 11 DEBTOR IN POSSESSION, AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

DESCRIPTION AND INTEREST OF *AMICUS CURIAE*[1]

Global Marine Inc. and certain of its subsidiaries ("Global") filed voluntary chapter 11 petitions with the Bankruptcy Court unit of the United States District Court for the Southern District of Texas, Houston Division, on January 27, 1986. Under the authority of sections 1107(a) and 1108 of the Bankruptcy Code, Global operates its business and manages its properties as a debtor in possession.

Global is engaged on a worldwide basis in the offshore oil and gas drilling business. Its fleet of 30 drilling rigs is one of the largest in the world, and Global is recognized as a premier driller in the industry. Its chapter 11 case was precipitated by the depression in the oil and gas industry, not by any operational deficiencies or problems on Global's part.

---

[1] This brief was filed with the consent of the parties involved; evidence of such consent is on file with the Clerk of the Court.

Global's rigs, which today are worth approximately $300 million, are encumbered by aggregate debt of approximately $1 billion. Various lenders hold separate components of that debt, with each component being secured by a ship or fleet mortgage on one or more of the rigs. Additionally, Global has unsecured public and trade debt of approximately $400 million, with only minor unencumbered assets available to satisfy those debts. Although Global has amassed a substantial amount of unencumbered funds, those funds constitute working capital that must be devoted to the funding of business operations until a recovery in the oil and gas industry enables such operations to be self-sustaining.

Despite its overwhelming debt, Global, because of its experience, expertise, marketing, and reputation, is worth more as an enterprise than the aggregate value of its 30 rigs. Accordingly, although Global may be unable to repay its total debt, Global believes that as a reorganized company it will repay its lenders more than they could obtain through foreclosure. Furthermore, the reorganization of Global would preserve it as a major employer in Houston and the United States, maintain it as a major competitor in the drilling market, and provide the United States with ability and knowhow necessary to grapple successfully with the next energy shortage.

If Global were required to compensate its secured lenders out of unencumbered assets for interest they could earn on foreclosure proceeds, the funds that are its only significant unencumbered asset would be exhausted, its business operations would cease for lack of working capital, and liquidation would soon follow. All of the foregoing benefits of reorganization would be lost.

STATEMENT OF THE CASE

The facts as set forth in the decision below appear undisputed and are incorporated herein by reference. Global submits this statement of the case only to point out one salient feature of those facts.

In ordering respondent, Timbers of Inwood Forest Associates, Ltd. ("Timbers"), to remit monthly cash payments of $42,500 to petitioner, United Savings Association of Texas ("United Savings"), the bankruptcy court below allowed Timbers to use a portion of the rents from the property to comply with the order. Timbers also used some of the rents to maintain the property.

Neither the payment of rents to United Savings nor the use of rents to preserve United Savings' collateral is at issue. The rents are part of United Savings' collateral security, and payment of them to United Savings or use of them to preserve United Savings' collateral simply constitutes partial satisfaction of United Savings' secured claim and maintenance of its collateral value. Such payment of rents is not unfair to unsecured claimholders who may look only to unencumbered assets for payment.

Only those amounts that the bankruptcy court ordered Timbers to pay to United Savings that exceed the rents encumbered in favor of United Savings are at issue. Those amounts would have to come from unencumbered assets of the estate and would constitute postpetition interest, not repayment of United Savings' secured claim. This issue is critically important in all cases in which the estate's encumbered property has value, but does not currently produce sufficient income or appreciation to pay the undersecured lender what it could earn if the property were sold and the proceeds reinvested.

SUMMARY OF ARGUMENT

The crux of the argument propounded by United Savings is that compensation for lost opportunity costs must be paid because Bankruptcy Code section 361 provides that adequate protection protects against decreases in the value of an entity's "interest in" property, as opposed to protecting against decreases in the "value of property." United Savings asserts that its "interest in" property includes its right to foreclose on and sell the property, and then to reinvest proceeds on a particular timetable.

Such talismanic significance cannot be loaded into the words "interest in." Those words are used only to extend the statute's coverage to situations in which the lender's interest in the property is less than the chapter 11 estate's entire interest in the property. The incorporation of foreclosure and reinvestment rights into the words "interest in" is a fanciful notion at best.

Seven provisions of the Bankruptcy Code support the conclusion that Timbers should not be required to pay postpetition interest to United Savings on its undersecured claim. Sections 502(b)(2) and 506 limit the allowability of postpetition interest to cases in which the value of the collateral security is sufficient to pay it. Sections 1110 and 1168 show that Congress carved out certain types of claims on which it would require payment of postpetition interest. An undersecured real estate mortgage claim, such as that held by United Savings, was not among them. Finally, the confirmation provisions of sections 1129, 1225, and 1325 demonstrate that Congress was conscious of the present value concept, knew how to draft present value language, and deliberately employed that language many times. There is not, however, one instance in which Congress used such language in connection with adequate protection.

The legislative history of the Bankruptcy Code expressly states that adequate protection exists to protect an allowed secured claim and to safeguard against the depreciation of collateral security.

Finally, the lost opportunity costs theory violates the public policies underlying the Bankruptcy Code, is at odds with the decisions of the Supreme Court, and constitutes judicial legislation designed to enable lenders and courts to terminate chapter 11 cases other than by the means Congress provided in sections 1112(b) and 1121 of the Bankruptcy Code.

ARGUMENT

I.

UNITED SAVINGS IS NOT ENTITLED TO ADEQUATE PROTECTION OF AN INTEREST IN PROPERTY IT DOES NOT HAVE.

Consistent with the last several centuries of English and American bankruptcy jurisprudence, the Bankruptcy Code disallows claims for postpetition interest, except with respect to oversecured claims or in instances of solvent estates.

A. Bankruptcy Code Sections 502(b)(2) and 506(a) Disallow Postpetition Interest on Undersecured Claims.

Bankruptcy Code section 502(b) only allows claims as of the date of the filing of the petition,[2] thereby cutting off postpetition interest claims. Furthermore, to prevent any entity from asserting a claim for future interest as of the date of the petition, section 502(b)(2) explicitly disallows claims for unmatured interest.

An exception to the disallowance of postpetition interest is made in the case of oversecured claims. Under Bankruptcy Code section 506(b),[3] the holder of a secured claim is allowed postpetition interest and other charges to the extent the claim is secured by property having a value that exceeds the sum of the amount of the allowed secured claim and the reasonable expense of preserving or disposing of the property.[4]

---

[2] 11 U.S.C. § 502(b), in pertinent part, provides:

> [If] objection to a claim is made, the court . . . shall determine the amount of such claim . . . *as of the date of the filing of the petition*, and shall allow such claim in such amount . . . (emphasis supplied).

[3] 11 U.S.C. § 506(b), in pertinent part, provides:

> To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

United Savings concedes that Bankruptcy Code section 502(b)(2) excludes postpetition interest from a creditor's allowed claim. Brief for Petitioner at 40 (hereinafter "United Savings Brief"). However, it argues for "the revival of postpetition interest to secured creditors in situations where equity demands." United Savings Brief at 44. Of the situations suggested by United Savings, two have been codified and the third has been overruled by statute. None justifies the revival of postpetition interest for United Savings in the case at bar.

The first two situations relate to the allowance of postpetition interest for oversecured creditors, codified in Bankruptcy Code section 506(b), and the allowance of postpetition interest for solvent estates, codified for chapter 7 cases in section 726(a)(5).[5]

United Savings' third situation is derived from *Sexton v. Dreyfus*, 219 U.S. 339 (1911). The last part of *Sexton's* holding stated that an undersecured creditor could apply earnings from its collateral security against postpetition interest, as opposed to applying the earnings against the amount of its prepetition claim. Aside from the fact that it is inequitable to the other unsecured creditors to treat the earnings from collateral differently from the collateral itself, that portion of the

---

[4] 11 U.S.C. § 506(c) provides:

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

Pursuant to Bankruptcy Code section 1107(a), Timbers, as debtor in possession, has the power of a trustee to recover the expenses and costs set forth in section 506(c).

[5] Section 726(a)(5) also applies to chapter 11 cases because impaired creditors in chapter 11 cases must obtain at least what they would receive in a chapter 7 case. 11 U.S.C. § 1129(a)(7)(A)(ii).

holding is overruled by sections 502(b)(2), 506(b), and 552(b) of the Bankruptcy Code. Section 552(b)[6] provides that postpetition proceeds, rents, and the like from a creditor's collateral security become subject to the creditor's security interest. Sections 502(b)(2) and 506(b) preclude the allowance of claims for postpetition interest unless the creditor is oversecured. Therefore, when a creditor is undersecured, as is United Savings, earnings from collateral security can only be applied to the prepetition claim.

United Savings attempts to retract its concession that postpetition interest is excluded from an allowed secured claim under section 502(b)(2) by positing that a creditor's allowed secured claim should be increased by "the amount that could be earned by liquidating the collateral and reinvesting the proceeds. . . ." United Savings Brief at 43. This contradicts Code section 502(b)(2), which excludes all postpetition interest from allowed claims, and Code section 506(a), which bifurcates an allowed claim into a secured claim and an unsecured claim.

If the increase in United Savings' secured claim increases its total allowed claim, then its allowed claim would include postpetition interest. This is not permitted by section 502(b)(2). Alternatively, if the increase in United Savings' secured claim decreases its unsecured claim, thereby leaving its total allowed claim unchanged, then, in the guise of obtaining adequate protection of its secured claim, United Savings would actually be receiving illegal payments on the unsecured portion of its claim.

---

[6] 11 U.S.C. § 552(b), in pertinent part, provides:

> [I]f the debtor and an entity entered into a security agreement before the commencement of the case and if the security interest created by such security agreement extends to property of the debtor acquired before the commencement of the case and to proceeds, product, offspring, rents, or profits of such property, then such security interest extends to such proceeds, product, offspring, rents, or profits acquired by the estate after the commencement of the case to the extent provided by such security agreement and by applicable nonbankruptcy law . . . .

B. Postpetition Interest Does Not Become Allowable by Recharacterizing it as Something "More Like Rent."

In light of the formidable bar to postpetition interest posed by sections 502(b)(2) and 506(a), United Savings employs *Black's Law Dictionary* to evade those sections and to claim that it is really seeking something more akin to rent than interest. United Savings Brief at 36. Because "interest" is defined as "compensation . . . for the use . . . of money,"[7] United Savings reasons that what it wants is not interest but something more like rent for the use of property in which it holds a security interest.

Characterizing unallowable postpetition interest as something "more like rent" is not a meritorious solution. Congress has legislated when postpetition rent should be paid, and it did not provide for rental payments to undersecured real estate mortgagees. In Bankruptcy Code section 1110(a), Congress requires postpetition debt service or rent to be paid to certain lenders and lessors in respect of aircraft and vessels. In section 1168, it does the same thing with respect to rolling stock. In section 365(d)(3), it requires postpetition rent payments to lessors of nonresidential real property. In other situations involving executory contracts and unexpired leases, the debtor pays fair value to the nondebtor party in exchange for obtaining postpetition benefits under the executory contract or unexpired lease. *See NLRB v. Bildisco and Bildisco*, 465 U.S. 513, 531 (1984).

In contrast, there is no statute or common law rule entitling an undersecured real estate mortgagee to any postpetition compensation. The mortgagee does not own the property, does not have a lease with the debtor, and does not have an executory contract with the debtor under which it provides any postpetition benefits. The mortgagee simply has a secured claim.

Secured claimholders have no more right to rent for the use of the estate's encumbered property than unsecured claimholders have to rent for the use of the estate's unencumbered property. "State law gives unsecured creditors a right similar to that of the secured creditor to foreclose his lien—the right to reduce their claims to judgment and pursue collection. Both rights are equally impaired by bankruptcy proceedings." *United Savings Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd.* (*In re Timbers of Inwood Forest Associates, Ltd.*), 808 F.2d 363, 374 (5th Cir.), *cert. granted*, ____ U.S. ____, 107 S.Ct. 2459 (1987) (Clark, J., concurring). Both secured claimholders and unsecured claimholders have contracts entitling them to payment at a certain time. The only distinguishing feature between the two is that the secured claimholder has first claim on a particular piece of property. *See* Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 Harv. L. Rev. 973 (1983). Neither creditor is entitled to the equivalent of rent on the assets from which it may be paid.

C. The Dissent Below Demonstrates that in the Face of Bankruptcy Code Sections 502(b)(2) and 506(b), Only Judicial Legislation Can Sanction Postpetition Interest.

When the dissent below ran into the literal terms of sections 502(b)(2) and 506(b), its solution was simple: "The § 502(b) 'interest' provision, like the other balance-sheet functions of § 502, is subject to qualification as necessary to accomplish certain goals within the Bankruptcy Code." *In re Timbers*, 808 F.2d at 379-80 (Jones, J., dissenting).

The dissent then demonstrated how it would change the focus of the Bankruptcy Code if it could wield the power to "qualify" congressional enactments to its liking:

> The objective candidate for a successful Chapter 11 reorganization is not hard to describe: it has some cash and a decent cash flow, encumbered or not; it has at least *some* lines of business that are profitable or nearly so; it has good management; and it is not facing a disastrous economic forecast in all of its markets. Given those conditions, if a court awards adequate protection recognizing the secured creditor's cost of delaying foreclosure, the debtor will not usually collapse, because it can afford some level of such protection; but it will propose a plan.

---

[7] *Black's Law Dictionary* 729 (5th ed. 1979).

Id. at 383-84 (Jones, J., dissenting)(emphasis in original). This test would, however, routinely exclude certain debtors whom Congress specifically made eligible for the benefits of reorganization.

Under the Bankruptcy Act of 1898, as amended,[8] Chapter XII was devoted to real estate developer reorganizations. When the Bankruptcy Code was enacted, former Chapter XII was incorporated into chapter 11, a single business reorganization chapter. Real estate developers typically are single asset debtors, primarily owing secured debt, and they are eligible for chapter 11 relief under Bankruptcy Code section 109(d). Nevertheless, because the dissent below does not believe that an entity with only one line of business is an objective candidate for success in chapter 11, it would qualify section 502(b)(2) to require the payment of postpetition interest, thereby forcing out of chapter 11 those candidates it deems unsuited, including nearly all real estate developers.

Notwithstanding that when Congress drafted the Bankruptcy Code one of its stated goals was to facilitate a financial return to the debtor's owners,[9] that bankruptcy legislation has traditionally been enacted in depression eras when forecasts were bleak,[10] and that the uncontested facts in the case at bar show that the value of the estate's property is within 3% of the debt against it, thereby creating a real possibility that a good rental program or other improvements could salvage some equity, the dissent below is convinced that Timbers is an inappropriate candidate for chapter 11 relief and should be

---

[8] Former 11 U.S.C. §§ 1-1103 (repealed 1978).

[9] As stated in the legislative history:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and ***produce a return for its stockholders.*** The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.

H. Rep. No. 595, 95th Cong., 1st Sess. 220 (1977) (emphasis supplied).

[10] *See id.* at 242 (first bankruptcy reorganization laws were enacted in the Great Depression).

forced out of chapter 11 by imposition of postpetition interest costs in excess of the current earnings from the collateral security that neither Timbers nor most other eligible real estate debtors can pay.[11]

The Bankruptcy Code contains creditor remedies designed to provide creditors with relief when a chapter 11 case is not serving the reorganization policy. The remedies include conversion of the case to chapter 7 pursuant to section 1112(b)[12] and promulgation of creditors' plans pursuant to section 1121(c).[13] The dissent below is apparently dissatisfied with bankruptcy judge enforcement of those remedies and states, as does one *amicus curiae*, that imposition of a lost opportunity costs requirement is intended as a substitute for enforcement of sections 1112(b) and 1121 of the Bankruptcy Code. *See In re Timbers*, 808 F.2d at 383 (Jones, J., dissenting); Brief for National Commercial Finance Association as *Amicus Curiae* in Support of Petitioner at 6-8 (hereinafter "NCFA Brief").

---

[11] That the dissent's position is nothing but judicial legislation is further shown by the Bankruptcy Code's legislative history. The penultimate Senate version of the Bankruptcy Code compelled the granting of relief from the automatic stay to a mortgagee of a single-asset real estate debtor whenever the debtor lacked equity. Even when the debtor had an equity in the collateral security, the court had to provide for a sale of the property on the ground that the property was not necessary to an effective reorganization. In pertinent part, section 362(d) of the Senate bill provided:

> For the purpose of this subsection (d), property is not necessary to an effective reorganization of the debtor if it is real property on which no business is being conducted by the debtor other than the business of operating the real property and activities incidental thereto .... Where a request is made to grant relief from the stay with respect to property not necessary to an effective reorganization of the debtor, and the court determines that the debtor has equity in the property, the court shall authorize or order the sale of the property pursuant to section 363.

S. 2266, 95th Cong., 2d Sess. § 362(d) (1977). Congress rejected the quoted language and it does not appear in the Bankruptcy Code. Thus, Congress considered and rejected the notion of denying relief to single-asset real estate debtors. The *Timbers* dissent would overrule Congress and deny relief to such debtors by manufacturing a postpetition interest requirement.

[12] 11 U.S.C. § 1112(b) provides that:

> [O]n request of a party in interest or the United States trustee, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title ... for cause ....

Ten examples of "cause" are provided in the section and a court may find other circumstances that provide cause for a conversion to chapter 7.

[13] 11 U.S.C. § 1121(c), in pertinent part, provides:

> Any party in interest, including ... a creditor ..., may file a plan if [a trustee has been appointed, the debtor has not filed a plan within 120 days, or the debtor has filed a plan which has not been accepted].

Rewriting congressional policy objectives and legislation is an inappropriate judicial undertaking even when the legislation is deemed absurd, which the Bankruptcy Code is not. As the Supreme Court stated in *Crooks v. Harrelson:*

> Courts have sometimes exercised a high degree of ingenuity in the effort to find justification for wrenching from the words of a statute a meaning which literally they did not bear in order to escape consequences thought to be absurd or to entail great hardship. But an application of the principle so nearly approaches the boundary between the exercise of the judicial power and that of the legislative power as to call rather for great caution and circumspection in order to avoid usurpation of the latter. It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the lawmaker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the lawmaking authority, and not with the courts.

Crooks v. Harrelson, 282 U.S. 55, 60 (1930)(citations omitted).

II.

NEITHER THE BANKRUPTCY CODE NOR ITS LEGISLATIVE HISTORY EVINCE ANY INTENT TO CHANGE PRIOR LAW PROVIDING THAT DELAY CAUSED BY AN ACT OF CONGRESS IS NOT CHARGEABLE AGAINST THE DEBTOR OR OTHER CREDITORS.

United Savings argues that section 502(b)(2) of the Bankruptcy Code is a nonsubstantive rule of law that does not prohibit postpetition interest in all cases. United Savings Brief at 38-39. Conversely, Global submits that section 502(b)(2) does prohibit postpetition interest in all cases, except for the explicit exceptions codified in section 506(b) (oversecured creditors) and section 726(a)(5) (solvent estates). Similarly, United Savings also argues that section 506(b) of the Bankruptcy Code does not bar postpetition interest where equity demands. *Id.* at 44. Global submits, on the other hand, that section 506(b) only allows postpetition interest to oversecured creditors and that the taking of unencumbered assets by an undersecured creditor for postpetition interest is well established to be inequitable.

Not only does section 502(b)(2)'s disallowance of unmatured interest have a very plain meaning, but it is consonant with established law that undersecured creditors have no equitable right to share in unencumbered assets of an estate on the basis of postpetition interest claims. In *Group of Institutional Investors v. Chicago, M., St.P. & P.R. Co.*, 318 U.S. 523 (1943), undersecured bondholders who had been stayed for approximately three years asserted claims for payment of postpetition interest from unencumbered assets of the estate. Their claim was disallowed, and the Supreme Court ruled:

> Since the distribution provided for these bonds on the basis of their mortgage securities is less than the principal amount of their claim, the limitation of their right to share the unmortgaged assets ratably with the unsecured creditors on the basis of principal and interest prior to bankruptcy only is justified under the rule of Ticonic National Bank v. Sprague, 303 U.S. 406, 58 S.Ct. 612, 82 L.Ed. 926.

Id. at 573. Only when a lender has been oversecured or the estate has been sufficient to pay all senior lenders has the Supreme Court allowed the lender postpetition interest in a bankruptcy case. *See, e.g., Ticonic Nat'l Bank v. Sprague*, 303 U.S. 406 (1938); *American Iron & Steel Mfg. Co. v. Seaboard Air Line Ry.*, 233 U.S. 261 (1914); *Coder v. Arts*, 213 U.S. 223 (1909).

United Savings and its supporting *amici curiae* claim that the denial of postpetition interest in bankruptcy cases serves only a bookkeeping function: it prevents creditors from distorting their ratable shares of the estate by accruing interest at different rates. That, however, is only one reason for denying postpetition interest. Another reason—that the implementation of the reorganization laws enacted by Congress necessarily delays the enforcement of some creditors' remedies, which delay should not be charged against the other parties or be cause for not carrying out the laws—has long been recognized by this Court.

In *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935), the Supreme Court upheld an injunction restraining secured noteholders from liquidating the mortgage bonds that they held as collateral. Even though no postpetition interest was being paid, *id.*, and the value of the collateral was subject to decline, the Court upheld the injunction in order to facilitate the reorganization that the bankruptcy law intended:

> It is a special proceeding which seeks only to bring about a reorganization, if a satisfactory plan to that end can be devised. And to prevent the attainment of that object is to defeat the very end the accomplishment of which was the sole aim of the section, and thereby to render its provisions futile.

Id. at 676.

In *Vanston Bondholders Protective Comm. v. Green*, 329 U.S. 156 (1946), senior secured bondholders were paid interest late and, pursuant to a provision in their indenture, requested compensation in the form of interest on the late interest. Because the late payment was due to the delays inherent in a Chapter X reorganization case, the Supreme Court upheld the denial of the bondholders' claim for what amounts to lost opportunity costs. The Court ruled:

> In either event, first mortgage bondholders would have been enriched and subordinate creditors would have suffered a corresponding loss, because of a failure to pay when payment had been prohibited by a court order entered for the joint benefit of debtor, creditors, and the public. Such a result is not consistent with equitable principles. For legal suspension of an obligation to pay is an adequate reason why no added compensation or penalty should be enforced for failure to pay.

Id. at 166-67. The primary beneficiaries of the ruling were subordinated creditors.

The legislative history of the Bankruptcy Code provides no hint that the foregoing principles have been changed, and the Court has frequently held that fundamental changes in bankruptcy law should not be read into the statute without a clear congressional expression that they were intended. *See, e.g.*, *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection*, 474 U.S. 494 (1986)(abandonment power); *Emil v. Hanley (In re John M. Russell, Inc.)*, 318 U.S. 515 (1943)(jurisdiction). *See also United States v. Whiting Pools, Inc.*, 674 F.2d 144 (2d Cir. 1982), *aff'd*, 462 U.S. 198 (1983)(turnover power).

United Savings attempts to overcome the foregoing authorities by claiming that a required payment of postpetition interest to secured creditors is lenient in comparison to the strict provisions of the pre-Bankruptcy Code law.[14] United Savings Brief at 10, 18-24. United Savings concedes that bankruptcy courts did not require payments for the cost of delay under prior law. *Id.* at 10, 18. It explains that fact by asserting that under prior law bankruptcy courts would terminate the automatic stay, whereas under the Bankruptcy Code they may condition its continuance on payments for delay. *Id.* at 19.

---

[14] The decisions cited by United Savings to show a "stricter" approach under prior law than it is arguing for under the Bankruptcy Code do not prove its point. The decisions mention accruing interest as one of several factors leading the courts to modify the automatic stay. The accruing interest, however, is used as a synonym for delay, which is always a factor the court may consider in determining motions for stay relief or dismissal. Most of United Savings' citations are of Chapter XI cases in which the court had no power to affect secured debt, and all of them had factors other than accruing interest as the primary cause for relief. For instance, *Bateman Fin. Corp. v. Glanville Mortgage Co. (In re Bateman Fin. Corp.)*, 5 Collier Bankr. Cas. (MB) 488 (Bankr. M.D. Fla. 1975), was a Chapter XI case in which the debtor had already been in bankruptcy for 14 months, had no business, and was solely trying in bad faith to stall foreclosure. *National Life Ins. Co. v. Jenifer Mall Corp. (In re Jenifer Mall Corp.)*, 2 Collier Bankr. Cas. (MB) 657 (Bankr. D.D.C. 1974), was a Chapter XI case in which the court found that the debtor had no chance of proposing a successful plan and that it was unable to affect secured debt. *C.I. Mortgage Group v. Groundhog Mountain Corp. (In re Groundhog Mountain Corp.)*, 1 Bankr. Ct. Dec. (CRR) 923 (Bankr. S.D.N.Y. 1975), was a Chapter XI case in which the debtor made no progress towards a plan in nine months and then belatedly raised all sorts of defenses to a mortgage, opening its good faith to question. As the court

The point of the balance of United Savings' brief, however, is that Bankruptcy Code section 361 mandates compensation for delay, not that such compensation is discretionary with the court. If United Savings means to suggest that postpetition interest is discretionary under the Bankruptcy Code, then it would be conceding that the plain language of section 361 does not compel such payment.

The discretionary approach was adopted in *Lend Lease v. Briggs Transp. Co.* (*In re Briggs Transp. Co.*), 780 F.2d 1339 (8th Cir. 1985). In *Briggs* the court held that whether adequate protection must include postpetition interest turns on a consideration of five factors.[15] The five factors seem always to require maintenance of the collateral value, but only to require payment of lost opportunity costs when the court determines that the purposes of chapter 11 are not being served or that reorganization is unlikely.

---

stated: "This is entirely too slim a reed upon which this Court should exercise its discretion and keep the plaintiff at bay while the debtor continues to pray." *Id.* at 926. The court's reference to its discretion refutes United Savings' assertion of a stricter approach under prior law. *In re Hartsdale Associates*, 11 Collier Bankr. Cas. (MB) 87 (Bankr. S.D.N.Y. 1976), was a Chapter XII case in which the debtor had no equity in its property and had enjoyed the benefit of the automatic stay for more than eight months. Even after finding no progress towards a plan, the court modified the stay of the foreclosure proceeding, but not of the foreclosure sale, so that the debtor would have an additional opportunity to propose a plan. Significantly, the bankruptcy judge who wrote *Hartsdale Associates* is the same judge who wrote *In re Pine Lake Village Apartment Co.*, 19 Bankr. 819 (Bankr. S.D.N.Y. 1982), which stands for the proposition that undersecured lenders have never been, and are not now, entitled to postpetition interest.

[15] The five factors are: (1) the quality of the collateral, (2) the duration of the stay, (3) whether the lien value is appreciating, depreciating, or remaining stable, (4) whether taxes and other payments designed to keep the collateral free of statutory liens are being or will be paid, and (5) whether there is a high chance of reorganization based on going concern values or only a slight chance of reorganization with the lender losing opportunity costs on its collateral's liquidation value. *Lend Lease v. Briggs Transp. Co. (In re Briggs Transp. Co.)*, 780 F.2d 1339, 1350 (8th Cir. 1985).

III.

BANKRUPTCY CODE SECTION 361 RESTRICTS ADEQUATE PROTECTION TO COMPENSATION FOR DEPRECIATION OF COLLATERAL SECURITY.

Bankruptcy Code section 361 provides that adequate protection of an entity's interest in property is to offset "a decrease in the value of such entity's interest in such property." 11 U.S.C. § 361(1) and (2). Congress used the words "entity's interest in such property" as opposed to the words "value of such property" because the latter phrase assumes that the debtor always pledges to a lender its entire interest in a property, which assumption is contrary to fact. A debtor might pledge as collateral security a future interest in a trust, a half interest in an oil and gas lease, a leasehold interest in real property owned in fee, or any other fractional interest of a whole ownership interest.

United Savings would incorporate into the words "interest in" the present value of its right under state law to foreclose, sell, and reinvest on a particular timetable. The notion that there ever is a particular timetable for foreclosure is a fiction. Whether a debtor defends against a judicial foreclosure or transforms a nonjudicial foreclosure into a judicial foreclosure by obtaining an injunction against the foreclosure, the timetable is anything but predictable. It is determined on a case by case basis by the vagaries of the state court docket, the habits of the judge, the complexity of the issues, the attentiveness of the attorneys, and many other variables.

But aside from the dubious premise that there is a predictable timetable, United Savings' construction of the words "interest in" is at odds with the statute, the legislative history, and the case law.

A. The Bankruptcy Code Utilizes "Time Value" Language, But Not in Connection with Adequate Protection.

In chapter 11 cases, the Bankruptcy Code requires that claimholders receive, under a chapter 11 plan, certain values "as of the effective date of the plan." For instance, general unsecured claimholders are entitled to "receive or retain under the plan . . . a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date." 11 U.S.C. § 1129(a)(7)(A)(ii). Similar time value language governs the value of distributions to priority claimholders and secured claimholders in chapter 11. *See* 11 U.S.C. § 1129(a)(9)(B) and (b)(2)(A)(i)(II). Chapters 12 and 13 contain equivalent language in connection with confirmation of plans. *See* 11 U.S.C. §§ 1225(a)(4), 1225(b)(1)(A), 1325(a)(4), 1325(a)(5)(B)(ii), and 1325(b)(1)(A).

In contrast, Bankruptcy Code section 361 does not anywhere provide that adequate protection protects an entity's reinvestment ability as of the date the entity would have foreclosed under state law.

In the absence of any time value language in section 361, United Savings grasps at the term "indubitable equivalent" in section 361(3). United Savings argues that since the term "indubitable equivalence" was used in *In re Murel Holding Corp.*, 75 F.2d 941, 942 (2d Cir. 1935), and since that court stated that interest is the common measure of the difference between payment ten years hence and payment now, adequate protection must include principal and interest because the term "indubitable equivalent" is used in section 361(3). United Savings Brief at 14-16. That argument is rebutted by both the language of section 361 and the facts of *Murel Holding*.

In providing examples of adequate protection, section 361(1) and (2) provide that adequate protection is to protect an entity against "a decrease in the value of such entity's interest in such property." Section 361(2) is connected to section 361(3) by the word "or." Thus, in addition to providing adequate protection by periodic payments or replacement liens as authorized by section 361(1) and (2), a debtor may provide adequate protection by means of such "other relief . . . as will result in the realization by such entity of the indubitable equivalent of such entity's interest in such property." 11 U.S.C. § 361(3). The language only provides the bankruptcy court flexibility to grant "other relief" so long as the relief protects against a decrease in the value of the entity's interest in property in a manner indubitably equivalent to periodic payments or replacement liens.

As explained above, the interest in property of an undersecured entity does not include postpetition interest.[16] United Savings is thus requesting adequate protection of an interest it does not have. *Murel Holding* is no help to United Savings. In that case, the debtor's section 77B[17] plan proposed payments to an oversecured first mortgagee of interest only for ten years. The court ruled that the plan did not adequately protect the mortgagee's lien because it did not safeguard the principal balance by the most indubitable equivalence. *Murel Holding*, 75 F.2d at 942.

The flaw in United Savings' use of *Murel Holding* is that it erroneously assumes that postconfirmation interest was provided to adequately protect the mortgagee's lien. The issue, however, was repayment of the value of the collateral—exactly what adequate protection is designed to protect under the Bankruptcy Code—and the court ruled that interest would compensate for delay in payment, but would not adequately protect the lien as required by statute.

The Supreme Court has long held that impairment of a lien and delay in its enforcement are two separate issues. *See United States v. Security Indus. Bank*, 459 U.S. 70, 75 (1982) ("[O]ur cases recognize, as did the common law, that the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral."); *Continental Illinois Nat'l Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 676-77 (1935) ("The injunction here in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action.").

Moreover, there was no dispute in *Murel Holding* over the creditor's obtaining postconfirmation interest on the allowed amount of its secured claim. *Murel Holding* never suggested that an undersecured mortgagee was entitled to postpetition interest notwithstanding statutory provisions disallowing interest. The court only considered the postconfirmation entitlements of an oversecured creditor, and its ruling simply insured that the mortgagee obtained the postconfirmation value of its lien, which was the indubitable equivalent provided for by section 77B. Accordingly, United Savings' reliance on *Murel Holding* as support for the proposition that adequate protection protects disallowed claims for postpetition interest is misplaced.

---

[16] *See* Argument Section I.A and B., *supra* at 5-9.

[17] Former 11 U.S.C. § 207.

B. The Legislative History Restricts Adequate Protection to Compensation for Depreciation of Collateral Security.

The legislative history of the Bankruptcy Code is devoid of any statement that adequate protection is intended to compensate for delaying a secured lender's foreclosure on collateral and reinvestment of proceeds. Indeed, United Savings admits that this is so, albeit by stating that Congress "did not specifically consider whether the secured creditor would be entitled to protection for the costs of delay. . . ." United Savings Brief at 27. In *Crocker Nat'l Bank v. American Mariner Indus., Inc.* (*In re American Mariner Indus., Inc.*), 734 F.2d 426, 430-31 (9th Cir. 1984), the United States Court of Appeals for the Ninth Circuit similarly admits that foreclosure and reinvestment rights are not mentioned.

The rationale of the Ninth Circuit in *American Mariner* is that Bankruptcy Code section 361 protects the value of an entity's interest in property, as opposed to the property value, because the entity's interest includes the timing of a secured lender's foreclosure and reinvestment rights. In harmony with *American Mariner*, United Savings argues that adequate protection protects "the *value of the creditor's interest in property*, rather than the amount of the allowed secured claim or the value of the property itself. . . ." United Savings Brief at 28 (emphasis in original). The fallacy of jamming the foreclosure and reinvestment rights timing concept into the words "interest in," rather than accepting their plain application to situations in which the creditor's lien extends to less than the whole of one of the estate's assets, is demonstrated by both the statute and the legislative history.

The statute rebuts United Savings' argument by making an allowed secured claim in property equal to "the value of such creditor's interest in the estate's interest in such property." 11 U.S.C. § 506(a). In other words, the allowed secured claim

and the creditor's interest in property are one and the same by statutory definition. United Savings' attempted differentiation between the two only shows that it is asking the Supreme Court to rewrite the statute.

The most reliable and definitive legislative history of the Bankruptcy Code[18] provides that "[a]dequate protection of an interest of an entity in property is intended to protect a creditor's allowed secured claim." 124 Cong. Rec. H 11092 (Sept. 28, 1978) (statement of Rep. Edwards); 124 Cong. Rec. S 17409 (Oct. 6, 1978) (statement of Sen. DeConcini). Simply put, United Savings reads this statute as saying that one can protect an allowed secured claim by requiring the payment of disallowed postpetition interest on such claim.

The legislative history specifies what adequate protection is supposed to protect. Foreclosure and reinvestment rights are nowhere included; depreciation of the collateral is. As is stated in the Senate Report:

> The first method of adequate protection outlined is the making of cash payments to compensate for the expected decrease in value of the opposing entity's interest.
>
> * * *
>
> The second method is the fixing of an additional or replacement lien on other property of the debtor to the extent of the decrease in value or actual consumption of the property involved.

S.Rep. No. 989, 95th Cong., 2d Sess. 54 (1978). *See* H.Rep. No. 595, 95th Cong., 1st Sess. 339 (1977).

The Senate Report then states that the periodic payments provided for in Bankruptcy Code section 361(1) are derived from *In re Bermec Corporation*, 445 F.2d 367 (2d Cir. 1971). In *Bermec* payments for "economic depreciation" were deemed sufficient to allow further prosecution of the reorganization case. *Id.* at 369. In respect of replacement liens, the Senate Report relies on *Wright v. Union Central Life Ins. Co.*, 311 U.S. 273 (1940), for the proposition that "it was the value of the secured creditor's collateral, and not necessarily his rights in specific collateral, that was entitled to protection." S.Rep. No. 989, 95th Cong., 2d Sess. 54 (1978).

---

[18] The only legislative report prepared in conjunction with the Bankruptcy Code as enacted was the report read into the record by Congressman Don Edwards and Senator Dennis DeConcini after the respective House and Senate versions of the Bankruptcy Code were reconciled into one bill. The report may be found at 124 Cong. Rec. H 11089 (Sept. 28, 1978) and 124 Cong. Rec. S 17406 (Oct. 6, 1978).

The Senate Report then explains where the Bankruptcy Code parts company with *Bermec*. It notes that periodic payments are appropriate when the collateral depreciates at a relatively fixed rate, and that such payments compensate for the depreciation. *Id.* The Senate Report voices uncertainty as to whether the payments offered in *Bermec* were adequate to compensate the creditors for their loss. *Id.* *Bermec* does not disclose whether the property was depreciating at a fixed rate. Additionally, the Senate Report repudiates the method employed in *Fruehauf Corp. v. Yale Express System, Inc.* (*In re Yale Express System, Inc.*), 384 F.2d 990 (2d Cir. 1967), to compensate a lessor for use of its trucks. In *Yale Express* the lessor was granted "equitable consideration in the reorganization plan," *id.* at 992, which was thought to be an administrative claim. The Senate Report states that adequate protection may not be granted in the form of an administrative claim because its payment is too uncertain. S.Rep. No. 989, 95th Cong., 2d Sess. 54 (1978).

Because the Senate Report stated that the modes of adequate protection were to compensate for depreciation, designated the decisions from which adequate protection was derived, and specified how adequate protection under the Bankruptcy Code differed from the cited decisions, it is difficult to imagine that it would fail to indicate that the cited decisions were additionally altered to require payment of lost opportunity costs, if the congressional intent had been to require such payment.

United Savings points to the provision in the House Report that "[s]ecured creditors should not be deprived of the benefit of their bargain." United Savings Brief at 33, *citing* H.Rep. No. 595, 95th Cong., 1st Sess. 339 (1977). However, United Savings fails to recognize that the only bargain a secured creditor has that sets it apart from an unsecured creditor is its

first claim to a particular piece of property. Both secured and unsecured creditors have debts due to them at certain times. The secured creditor forecloses on and sells its collateral security, while the unsecured creditor obtains a judgment and executes on a debtor's unencumbered property. Thus, unless Congress intended to entitle unsecured creditors to compensation for delay in executing on and reinvesting the proceeds of unencumbered property, the only bargain that could have been referred to in the House Report is the bargain to have a first claim to a piece of property. Compensating creditors for depreciation of their collateral, whether by periodic payments or replacement liens, preserves that bargain.

IV.

REFUTATION OF MYTHS SUPPORTING LOST OPPORTUNITY COSTS

Many myths abound in respect of the authority for and the implementation of the lost opportunity cost theory. Global addresses these myths below.

A. *Butner* Is Not Authority for the Lost Opportunity Cost Theory.

The issue in *Butner v. United States,* 440 U.S. 48 (1979), was whether state or federal law should determine whether a mortgagee or a bankruptcy trustee had a prior right to rents collected after the mortgagor's bankruptcy and before the foreclosure sale. The Supreme Court held that while Congress could, in the exercise of its bankruptcy power, pass a federal law, it had not done so. Therefore, state law governed. *Id.* at 54-55.

It does not follow, however, that mortgagees are entitled to their foreclosure and reinvestment rights in a bankruptcy case. First, by its nature, bankruptcy law supplants state law remedies and substitutes remedies of its own that are geared to eliminate grab law and promote reorganization. Second, Congress has exercised its bankruptcy power to supersede the timing of a mortgagee's foreclosure rights by legislating the automatic stay, as set forth in section 362(a) of the Bankruptcy Code, and the disallowance of unmatured interest, as set forth in section 502(b) of the Bankruptcy Code.

B. The Enactment of Chapter 12 Did Not Codify Lost Opportunity Costs in Chapter 11.

Because *Crocker Nat'l Bank v. American Mariner Indus., Inc.*, (*In re American Mariner Indus., Inc.*), 734 F.2d 426 (9th Cir. 1984), found the lost opportunity costs requirement in the words "interest in" and "indubitable equivalent" in section 361 of the Bankruptcy Code, the drafters of chapter 12, which is a special debtor-relief act for family farmers, deleted those words in section 1205(b) of the Bankruptcy Code. Thus, subsections 1205(b)(1) and (b)(2) provide an entity with adequate protection against a "decrease in the value of property securing a claim," and not against a "decrease in the value of the entity's interest in the property," and in so doing avoid the *American Mariner* problem.

United Savings and the dissent below reason that the avoidance of *American Mariner* in chapter 12 somehow evidences congressional intent that *American Mariner* apply in chapter 11. United Savings Brief at 29-30 n.16; *In re Timbers*, 808 F.2d at 376 (Jones, J., dissenting).

However, when section 1205 was enacted on October 27, 1986, *American Mariner* was only one of several positions on the subject in the United States. On the circuit court level, it was only followed in the Fourth Circuit. *See Grundy Nat'l Bank v. Tandem Mining Corp.*, 754 F.2d 1436, 1440 (4th Cir. 1985). The decision below governed in the Fifth Circuit, and a discretionary rule governed in the Eighth Circuit. *See Lend Lease v. Briggs Transp. Co.* (*In re Briggs Transp. Co.*), 780 F.2d 1339 (8th Cir. 1985). This discretionary approach has been approved by several other courts. *See, e.g., In re Park West Hotel Corp.*, 64 Bankr. 1013, 1020 n.4 (Bankr. D. Mass 1986) and *In re 12th & N Joint Venture*, 63 Bankr. 36 (Bankr. D.D.C. 1986). Moreover, numerous courts had questioned or explicitly rejected the *American Mariner* analysis. *See, e.g., John Hancock Mut. Life Ins. Co. v. Pullins* (*In re Pullins*), 65 Bankr. 560 (Bankr. S.D. Ohio 1986); *In re Island Helicopter Corp.*, 63 Bankr. 809 (Bankr. E.D.N.Y. 1986); *United States v. Smithfield Estates, Inc.*, (*In re Smithfield Estates, Inc.*), 48 Bankr. 910, 914 n.8 (Bankr. D.R.I. 1985); *In re Keller*, 45 Bankr. 469 (Bankr. N.D. Iowa 1984); and *In re Manville Forest Products Corp.*, 43 Bankr. 293, 302 n.7 (Bankr. S.D.N.Y. 1984). Given the irreconcilable conflict in the courts among three competing positions, it is inconceivable that Congress intended, by its adoption of chapter 12, to incorporate the *American Mariner* rule into chapter 11 without taking a single act that would demonstrate such an intent.

Finally, the dissent below argues that if *American Mariner* does not apply to chapter 11, then chapter 12 is more onerous than chapter 11. *See In re Timbers*, 808 F.2d at 379 (Jones, J., dissenting). The dissent reasons that because section 1205(b)(3) compels farmers to pay rent to lenders rather than opportunity costs, if opportunity costs are not required in chapter 11, chapter 12 would carry a heavier burden. *Id.* That argument completely misreads section 1205(b).

Each of the four subdivisions of section 1205(b) are alternatives. The word "or" is used. While subdivision (3) of section 1205(b) allows adequate protection to be in the form of fair rental value, that is only one alternative. More significantly, subdivision (3) can only be fully understood after reading subdivision (4). The latter subdivision refers to providing other types of adequate protection to protect the "value of property securing a claim *or of such entity's ownership interest in property.*" 11 U.S.C. § 1205(b)(4) (emphasis supplied). In other words, subdivision (4) shows that adequate protection in chapter 12 is not only intended for lenders, but is also intended for landlords.[19] In that context, it is easy to understand why

---

[19] In chapter 11 cases, many courts have determined that adequate protection is not applicable to lessors. *See, e.g., Harris Int'l Telecommunications, Inc. v. Three Star Telecast, Inc. (In re Three Star Telecast, Inc.)*, 73 Bankr. 270 (Bankr. D.P.R. 1987); *In re Sweetwater*, 40 Bankr. 733 (Bankr. D. Utah 1984), *aff'd*, 57 Bankr. 743 (D. Utah 1985); *Southside Leasing Co. v. Merchants Plaza, Inc. (In re Merchants Plaza, Inc.)*, 35 Bankr. 888 (Bankr. E.D. Tenn. 1983); *Bistrian v. East Hampton Sand & Gravel Co. (In re East Hampton Sand & Gravel Co.)*, 25 Bankr. 193 (Bankr. E.D.N.Y. 1982).

Congress enacted subdivision (3). It is the most logical means of granting adequate protection to a landlord. It need not ever be invoked for lenders.[20]

C. Splitting One Lien into Two Does Not Change Adequate Protection Requirements.

One *amicus curiae* argues that the decision below prohibits payment of postpetition interest to a mortgagee owed $150,000 secured by property worth $100,000, but does not prohibit payment of postpetition interest to a mortgagee owed $90,000 secured by property worth $100,000. NCFA Brief at 20-21. That is true, but only to the extent the interest does not exceed $10,000 less the estate's reasonable expense of preserving or disposing of the property. *See* 11 U.S.C. § 506(c).

That same *amicus curiae* then claims that, if in the latter situation a second mortgagee is owed $60,000, the second mortgagee is routinely granted interest to protect against the first mortgagee's accruing interest. The decision below does not sanction such a result. Under that decision the property value of $100,000 is the only value to be protected. While interest on the first mortgagee's $90,000 debt may consume the initial $10,000 equity of the second mortgagee, that result is simply a function of the fact that the second mortgagee has taken a subordinated position to the first mortgagee. Adequate protection was not designed to protect lenders against contractual subordination agreements that they enter into voluntarily. In fact, subordination agreements are enforceable in bankruptcy. *See* 11 U.S.C. § 510.

Additionally, this argument assumes the existence of an unrealistically static situation. In the normal commercial situation, if a property has a value of $100,000, it will either generate income or appreciate, thus enabling its owner to earn a fair market return. If it does neither, then it is a contradiction in terms to say it is worth $100,000. Conversely, if it does generate income or appreciate, the accretion or appreciation will redound first to the benefit of the first mortgagee and then to the benefit of the second mortgagee. *See* 11 U.S.C. § 552(b). That may preserve the second mortgagee's position.

If the case is hopeless, the solution for the second mortgagee is a conversion or dismissal under Bankruptcy Code section 1112(b), not the imposition of a postpetition interest requirement in violation of sections 502(b)(2) and 506(b). It is sheer hyperbole to charge that under the decision below, a "creditor's collateral may be used *indefinitely*, without compensation, for the benefit of the debtor and its unsecured creditors, particularly when the collateral (such as land) is not depreciating in value . . . ." NCFA Brief at 7 (emphasis in original).

Indeed, the decision below champions the use of creditor remedies in the Bankruptcy Code to protect creditor interests and to arrest chapter 11 cases not fulfilling valid goals. *See In re Timbers*, 808 F.2d at 370-74. Creditors need only use the remedies that Congress has provided,[21] not seek judicial legislation of remedies that frustrate the congressional purpose.

Notably, neither United Savings nor any *amicus curiae* has called the Supreme Court's attention to a single case in which a bankruptcy court failed to apply section 1112(b) correctly. The bottom line is that the Bankruptcy Code does work. Some creditors, however, would prefer to have trump cards (such as postpetition interest) which will give them more leverage by enabling them to terminate a bankruptcy case through a request for payments the estate has insufficient cash to make.

D. Chapter 11 Serves National Interests, All Creditors, Employees, and Owners, Not Just Unsecured Creditors.

Imagine a widget manufacturing company with debt of $1 million. If it liquidates, the manufacturing equipment may be sold for scrap, jobs will be lost, the economy will have one less competitor, creditors will obtain ten cents on the dollar, and owners will lose their entire investments. If it reorganizes, jobs will be preserved, the company will remain a competitor, creditors will obtain fifty cents on the dollar over time, and the owners will lose their investments or have their ownership interests drastically diluted.

---

[20] A legislative remark is quoted by an *amicus curiae* to show that Bankruptcy Code section 1205(b)(3) was intended to compel farmers to pay their mortgagees' lost opportunity costs. NCFA Brief at 14. That remark prompts an obvious question: if section 1205(b)(3) was intended to codify *American Mariner* for farmers, why were subsections 1205(b)(1) and (2) carefully tailored to overrule *American Mariner*? Global submits that the meaning of section 1205(b)(3) set forth in the text above is correct and the legislative remark is just misguided. The other possible explanation is that Congress was diabolically duped into thinking it was overruling *American Mariner* for farmers, when it was in fact codifying it. That seems highly unlikely.

[21] *See, e.g., Koerner v. Colonial Bank (In re Koerner)*, 800 F.2d 1358 (5th Cir. 1986).

Are the benefits of reorganization to the nation, the employees, or the creditors any different if the debt is secured rather than unsecured? The answer is "no." If the manufacturing equipment is unencumbered, it will be worth a great deal more to creditors as part of a going concern than it will be worth to them as scrap. This result does not change if the equipment is encumbered.

Moreover, Congress did not enact the Bankruptcy Code solely for the benefit of creditors. It expressly stated that business reorganization was designed to assist employees and owners. *See* note 9, *supra*. Congress also enacted chapter 11 to benefit the economy: "If the business can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets." H.Rep. No. 595, 95th Cong., 1st Sess. 220 (1977).

Although one *amicus curiae* argues that reorganization benefits general creditors and owners, but not secured creditors,[22] reorganization actually benefits the full spectrum of parties in interest, from secured creditors to general creditors to owners, and extends its benefits to employees and the national economy as well. Thus, the argument that the delay costs inherent in the chapter 11 process should not be shared by secured creditors is simply wrong.

E. *First Lutheran Church* Does Not Apply to the Case at Bar.

Issues concerning a taking by government for public use under the Fifth Amendment have not been raised in the case at bar. Nevertheless, United Savings cites *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles*, ____

---

[22] Brief for *Amicus Curiae* (by Thomas H. Jackson, *pro se*) at 14.

U.S. ____, 107 S.Ct. 2378 (1987), for the proposition that a secured creditor whose rights are delayed is similarly entitled to compensation for the delay. United Savings Brief at 32.

In *First Lutheran Church*, the county government passed an ordinance that, according to the church, prohibited it from making any use of its property. On those facts, the Supreme Court held that the church would be entitled to compensation for a taking, even for the time before which the taking is finally determined.

First Lutheran Church is inapplicable here for numerous reasons. United Savings is not being prohibited from receiving the net rental income from the property its lien encumbers. It is only being restrained from selling that property. Thus, United Savings cannot claim that it has been deprived of its lien. In *First Lutheran Church*, the Supreme Court carefully noted that it was limiting its holding to the facts and did not deal with different questions involving normal delays. Additionally, United Savings entered into its mortgage with full knowledge of the power of Congress to impair contractual remedies. *See United States v. Security Indus. Bank*, 459 U.S. 70, 74 (1982); *First Nat'l Bank of Chicago v. Prima Co.* (*In re Prima Co.*), 88 F.2d 785, 788 (7th Cir. 1937).

Moreover, United Savings is delayed only in the exercise of a remedy that it will never exercise if the chapter 11 case results in a restructuring of United Savings' mortgage. In sum, United Savings' claim to compensation for its inability to foreclose swiftly is tantamount to the proposition that United Savings may tax Timbers and its creditors for the exercise by Congress of its bankruptcy powers. This position is untenable. The Bankruptcy Code protects property interests; it does not protect those state law remedies that it displaced to prevent grab law and dismemberment. *See generally* M. Bienenstock, *Bankruptcy Reorganization* 170-89 (1987).

CONCLUSION

Global requests the Supreme Court to affirm in all respects the decision of the United States Court of Appeals for the Fifth Circuit.

Respectfully submitted,

Harvey R. Miller*
D. J. Baker
Martin J. Bienenstock
Rosalie E. Walker

Weil, Gotshal & Manges
767 Fifth Avenue
New York, New York 10153
(212) 310-8000
-and-
1600 RepublicBank Center
Houston, Texas 77002
(713) 546-5000

Attorneys for *Amicus Curiae,*
Global Marine Inc.,
Chapter 11 Debtor in
Possession

John G. Ryan
General Counsel
Global Marine Inc.
777 North Eldridge
Houston, Texas 77079
(713) 596-5100

*Attorney of Record